No. 91-321-CSX
Status: GRANTED

Title: Itel Containers International Corporation, Petitioner
v.
Joe Huddleston, Commissioner of Revenue of Tennessee

Docketed:
August 21, 1991

Court: Supreme Court of Tennessee, Middle Division

Counsel for petitioner: Collier,Philip W.

Counsel for respondent: Burson,Charles W.

7/10: Ord. granting ext. of time to file, to 8/21, by Stevens, J. (CITED).

Entry	Date	Note	Proceedings and Orders
1	Jul 8 1991	G	Application (A91-29) to extend the time to file a petition for a writ of certiorari from July 22, 1991 to August 21, 1991, submitted to Justice Stevens.
2	Jul 10 1991		Application (A91-29) granted by Justice Stevens extending the time to file until August 21, 1991.
3	Aug 21 1991	G	Petition for writ of certiorari filed.
5	Sep 20 1991		Brief of respondent Joe Huddleston, etc. in opposition filed.
4	Sep 25 1991		DISTRIBUTED. October 11, 1991
6	Oct 2 1991	X	Reply brief of petitioner Itel Containers filed.
7	Oct 15 1991	P	The Solicitor General is invited to file a brief in this case expressing the views of the United States.
8	Jan 23 1992		Brief amicus curiae of United states filed.
9	Jan 29 1992		REDISTRIBUTED. February 21, 1992
10	Jan 30 1992	X	Supplemental brief of petitioner Itel Containers filed.
11	Feb 24 1992		Petition GRANTED.
			**********
13	Mar 13 1992		Order extending time to file brief of petitioner on the merits until April 30, 1992.
14	Apr 20 1992	G	Motion of petitioner to dispense with printing the joint appendix filed.
15 -	Apr 27 1992		Motion of petitioner to dispense with printing the joint appendix GRANTED.
16	Apr 27 1992	G	Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument filed.
17	Apr 30 1992		Brief amici curiae of Pacific Merchant Shipping Assn., et al. filed.
18	Apr 30 1992		Brief amici curiae of Asia North America Eastbound Rate Agreement, et al. filed.
20	Apr 30 1992		Brief amicus curiae of United Kingdom of Great Britain and Northern Ireland filed.
21	Apr 30 1992		Brief of petitioner Itel Containers filed.
19	May 1 1992		Brief amici curiae of Institute of International Container Lessors, et al. filed.
22	May 8 1992	D	Motion of Institute of International Container Lessors, et al. for leave to participate in oral argument as amici curiae, for divided argument and for additional

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Entry	Date	Note	Proceedings and Orders
			time for argument filed.
23	May 18 1992		Motion of the Solicitor General for leave to participate in oral argument as amicus curiae and for divided argument GRANTED.
24	May 18 1992		Motion of Institute of International Container Lessors, et al. for leave to participate in oral argument as amici curiae, for divided argument and for additional time for argument DENIED.
26	May 19 1992		Order extending time to file brief of respondent on the merits until June 25, 1992.
27	Jun 10 1992		Record filed.
		*	Original proceedings Supreme Court of Tennessee (1 Box)
28	Jun 25 1992		Brief of respondent Joe Huddleston, etc. filed.
29	Jun 25 1992		Brief amicus curiae of United States filed.
30	Jul 10 1992		CIRCULATED.
31	Jul 21 1992		SET FOR ARGUMENT WEDNESDAY, OCTOBER 14,1992. (2ND CASE).
32	Jul 29 1992	X	Reply brief of petitioner filed.
33	Oct 14 1992		ARGUED.

91-321

No.

Supreme Court, U.S.
FILED
AUG 21 1991
OFFICE OF THE CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1991

ITEL CONTAINERS INTERNATIONAL CORPORATION,
PETITIONER

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE,
STATE OF TENNESSEE, RESPONDENT

Petition for a Writ of Certiorari to the Tennessee Supreme Court

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PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the Foreign Commerce Clause precludes the imposition of a state sales tax on the lease of instruments of international traffic that enter the United States under Customs bond and are used exclusively in foreign commerce.

2. Whether the imposition of such a tax is preempted by the Customs Conventions on Containers.

3. Whether the Import-Export Clause precludes the imposition of a state sales tax on imported or exported goods while they are in transit.

RULE 29.1 STATEMENT

Petitioner Itel Containers International Corporation is a wholly owned subsidiary of Itel Corporation. Itel Containers International Corporation has two partially-owned subsidiaries, SSI Containers, Ltd., and Itel Containers International, SRL.

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ITEL CONTAINERS INTERNATIONAL CORPORATION,
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v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE,
STATE OF TENNESSEE, RESPONDENT

Petition for a Writ of Certiorari to the Tennessee Supreme Court

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PETITION FOR A WRIT OF CERTIORARI

OPINIONS BELOW

The opinion of the Supreme Court of Tennessee (App. *infra*, 1a-18a) is designated for publication but has not yet been published. The opinion of the Tennessee Court of Chancery (App., *infra*, 19a-26a) is not reported.

JURISDICTION

The judgment of the Tennessee Supreme Court was entered on April 22, 1991. On July 10, 1991, Justice Stevens extended the time within which to file the petition to and including August 21, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1257(a).

CONSTITUTIONAL, STATUTORY, AND REGULATORY PROVISIONS INVOLVED

The relevant portions of the following constitutional, statutory, and regulatory provisions are reproduced in the appendix to the petition at 38a-44a: the Commerce Clause (Art. I, § 8, Cl. 3), the Import-Export Clause (Art. I, § 10, Cl. 2) and the Supremacy Clause (Art. VI, Cl. 2) of the United States Constitution; the Customs Convention on Containers, Dec. 2, 1972, 988 U.N.T.S. 43; the Customs Convention on Containers, May 18, 1956, [1969] 20 U.S.T. 301; 19 U.S.C. 1322(a); 19 C.F.R. 10.41a(1)(a); 19 C.F.R. 115.1; and Tenn. Code Ann. 67-6-102 (1989).

STATEMENT

This case involves a challenge to the imposition of Tennessee's sales tax on the lease of cargo containers used exclusively in foreign commerce; the tax was upheld by Tennessee courts against an attack grounded on the United States Constitution. The containers subject to tax were Customs bonded and sealed instruments of international traffic prohibited from use in domestic commerce. Most lessees of the containers, who in large part absorb the tax, are foreign domiciliaries. The exaction of the tax therefore both imposes an unwarranted burden on goods exported from and imported to the United States, and threatens to prompt retaliation by our trading partners against American firms. Because the decision below is inconsistent with holdings of this Court—and because the Tennessee tax places the United States in violation of its international treaty obligations—further review is warranted.

The Container Industry. Cargo containers are specially manufactured steel boxes, typically eight feet high, eight to 9.5 feet wide, and between eight and 40 feet long, that are used as articles of transport equipment. See *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 436 n.1 (1979). Because they are reusable, may be

loaded and unloaded mechanically, and are designed to be carried by truck, rail, and oceangoing vessel, containers have greatly reduced the cost of shipping cargo. See Simon, *The Law of Shipping Containers*, 5 J. Mar. L. & Com. 507, 513 (1974). Their use in recent decades is often described as having revolutionized the transport of goods (see *id.* at 507), and containers now provide the principal means for marine transportation of imported and exported goods. Containers accounted for 60% of the value of American marine imports and 52% of the value of American marine exports in 1990. Bureau of the Census SM705. The value of American goods exported by container in 1990 exceeded $84 billion. *Ibid.* Containers were utilized for the marine transport of a variety of crucial American exports in 1990: 59% of the value of exported chemicals and related products, 61% of the value of exported machinery and transport equipment, 69% of the value of manufactured goods and 89% of the value of exported beverages and tobacco. *Ibid.* Some 25% of these containers, with a market value of approximately $2.5 billion, are owned by firms domiciled in the United States. Br. of International Institute of Container Lessors as *Amicus Curiae* before the Tenn. Sup. Ct. at 2.

The Customs Conventions. The use of containers in foreign commerce is promoted and regulated by the 1972 Customs Convention on Containers (the "1972 Convention"), 988 U.N.T.S. 43, acceded to by the United States in 1985, and the 1956 Customs Convention on Containers (the "1956 Convention"), May 18, 1963, [1969] 20 U.S.T. 301.[1] The chief device for promoting international shipment of goods by container is the fiction of "temporary admission": the Conventions prevent containers from entering the domestic commerce of any signatory nation.

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[1] The 1972 Convention replaces the 1956 Convention in dealings between signatories to the 1972 Convention.

The 1972 Convention obligates signatory nations to admit containers "free of import duties and taxes and free of import prohibitions and restrictions" (Arts. 1(b), 3, 988 U.N.T.S. 44-45). The term "import duties and taxes" is broadly defined to "mean Customs duties *and all other duties, taxes, fees and other charges* which are collected on, or in connection with, the importation of goods, but not including fees and charges limited in amount to the approximate cost of services rendered." Art. 1(a), *id.* at 44 (emphasis supplied). The 1972 Convention requires strict regulatory compliance to qualify for these benefits.[2]

The Conventions have been implemented in the United States by statute and regulation. The Secretary of the Treasury, acting pursuant to 19 U.S.C. 1322(a), has designated containers as "instruments of international traffic" that are excepted from application of the Customs laws. 19 C.F.R. 10.41a(a)(1), (3).[3] To receive this special treatment, however, a container owner must provide assurances that its containers will not be used in interstate or intrastate commerce; if the containers are diverted to point-to-point local use within the United States, the owner must make entry and pay the applicable Customs duty. Each owner must post a continuous bond with the Customs Service to secure compliance with this under-

[2] The 1972 Convention limits the use of containers in domestic traffic (art. 9, *id.* at 46; Annex 3, *id.* at 52) and provides for the admission of container parts and accessories (art. 10-11, *id.* at 46), the approval of containers used to transport goods under Customs seal (art. 12, *id.* at 47; Annex 5, *id.* at 61-67), the making of containers (Annex 1, *id.* at 51-52), the obligations of container owners (Annex 2, *id.* at 52), and the design of containers (Annex 4, *id.* at 52-61).

[3] Containers are one of many articles that have been designated as instruments of international traffic by the Customs Service, including skids, pallets, cores for textile fabrics and other permanent items used to facilitate international transport. The Secretary of the Treasury has similarly excepted locomotives, buses, trucks and taxicabs that are used solely in foreign commerce from entry or the payment of duties. 19 C.F.R. pt. 123.

taking. 19 C.F.R. 10.41a(a), (c), 113.66. In addition, 19 C.F.R. pt. 115 implements the 1972 Convention's procedures for the certification and approval of containers used in transporting goods under Customs seal. Compliance with the procedures allows steamship lines to move containers from the point of loading to the ultimate destination without the presentation of papers to or inspection by Customs officials.

Itel's Business. Itel is a Delaware corporation with its principal place of business in California. During the relevant period, it leased cargo containers that were used exclusively in foreign commerce. The containers were manufactured and purchased abroad by Itel, and entered the United States certified for the transport of goods under Customs seal. Itel posted a continuous bond with the Customs Service undertaking not to withdraw its containers from foreign commerce. All of Itel's leases accordingly restricted use of the containers to international commerce. App., *infra*, 2a. The leases were solicited and negotiated through marketing offices in California, Texas, Illinois, New Jersey, South Carolina and Washington. In addition, Itel operated container terminals and made use of so-called "third-party" terminals—facilities operated by independent contractors that tendered delivery and accepted returns of containers—worldwide. Itel allowed its lessees to accept delivery of and return containers at the terminals. *Id.* at 31a.

Itel operated one terminal and used several third party terminals in Tennessee. Containers were delivered at those points to common carriers hired by Itel's lessees, who initially used the containers to export goods from the United States. None of the leases during the relevant period, however, was solicited, negotiated, or executed in Tennessee. App., 2a-3a, 30a-33a. Most of the lessees who accepted delivery of containers in Tennessee were international steamship lines domiciled in foreign countries, including companies domiciled in Australia, Colombia, France, Germany, Iceland, Israel, New Zealand, Norway,

Singapore, Sweden, Switzerland, the United Kingdom, and Venezuela. Trial Tr. 31-33. While each container initially was used to export American goods to foreign ports, most containers were used continuously in multiple import-export shipments. All of Itel's leases culminated with an import shipment terminating in a Customs Convention signatory nation; 61% of the leases concluded with the importation of goods into the United States. Itel Trial Ex. 3, 7, 13.

The Assessment. In 1986, the Tennessee Department of Revenue assessed Itel $348,571 in back sales taxes, penalties and interest on the proceeds earned from the lease [4] of containers that Itel delivered in Tennessee to international carriers.[5] While Itel is obligated to collect the tax from its lessees "insofar as it can be done" (Tenn. Code Ann. 67-6-502 (1971)), the legal incidence of the tax falls on Itel, and only Itel may contest its imposition. See *Beare Co. v. Olsen*, 711 S.W.2d 603, 605 (Tenn. 1986). Itel accordingly paid the tax under protest and began this action for a refund, challenging the constitutionality of the tax under the Commerce, Import-Export, and Supremacy Clauses of the United States Constitution. The Tennessee Chancery Court rejected the claim. App., *infra*, 19a-26a.[6]

The State Court Opinion. The Tennessee Supreme Court affirmed. App., *infra*, 1a-18a. It recognized this Court's holding in *Japan Line* that a state ad valorem property tax on containers owned by foreign domiciliaries violates the Foreign Commerce Clause. The court also

[4] Tennessee's 5.5% sales tax is imposed on "any transfer of title or possession, or both, exchange, barter, lease or rental * * * for a consideration." Tenn. Code Ann. 67-6-102(23)(A) (1989).

[5] Petitioner already was paying sales and use taxes on fees collected in connection with repair services performed at its Memphis terminal. Those taxes are not at issue here. See App., *infra*, 2a-3a.

[6] The court reduced the assessment by $224,453 on other grounds, however. The State did not appeal the reduction.

acknowledged that "Itel's containers, like Japan Line's containers, are instrumentalities of foreign commerce" (*id.* at 7a), and it expressly declined to distinguish *Japan Line* on the ground that in this case the tax happens to fall on a domestic domiciliary. *Id.* at 7a-8a. Instead, the court found a constitutional distinction between sales and property taxes (see *id.* at 12a), holding that state sales taxes by their very nature satisfy the requirements of the Foreign Commerce Clause because they pose no risk of multiple taxation (*id.* at 14a-15a) and cannot interfere with the federal government's management of foreign relations or international trade. *Id.* at 15a-16a.

The court next held that the Tennessee tax was not preempted by the Container Conventions and the Treasury Department's implementing regulations. It distinguished this Court's decisions in *Xerox Corp. v. Harris County*, 459 U.S. 145 (1982), and *McGoldrick v. Gulf Oil Corp.*, 309 U.S. 414 (1940) (holding that state property and sales taxes are preempted by federal statutes that exempt goods from Customs duties when they are stored under bond in designated warehouses), finding that federal regulation of Customs bonded containers is "less pervasive" than the regulation of Customs bonded warehouses. App., *infra*, 14a. The court also reasoned that preemption is inappropriate because the Container Conventions were not intended to benefit container owners. *Id.* at 10a.

Finally, the court turned aside Itel's claim under the Import-Export Clause. In rejecting the argument that the Tennessee tax is invalid under *Richfield Oil Corp. v. State Board of Equalization*, 329 U.S. 69 (1946), the court below evidently concluded that *Richfield's* holding did not survive this Court's more recent decisions in *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976), and *Department of Revenue v. Ass'n of Washington Stevedoring Cos.*, 435 U.S. 734 (1978). See App., *infra*,

16a-17a. And in applying the Import-Export Clause test set out in *Michelin*, the court again found it dispositive that the tax at issue here is one on sales rather than on property. *Id.* at 18a.

REASONS FOR GRANTING THE PETITION

This case presents issues of considerable importance to the foreign relations and import/export trade of the United States. The United States and 52 other nations, as signatories to the Customs Conventions on Containers, have pledged to erase international borders for purposes of container transport. To this end, the Customs Conventions prohibit import duties or taxes except fees limited to the approximate cost of services rendered. The Conventions do not allow any other form of local taxation. Moreover, the custom of the signatory nations under the Conventions is to abstain from imposing transaction taxes upon sales or leases of containers. Because the Conventions reflect "a national policy to remove impediments to the use of containers as 'instruments of international traffic,'" Tennessee's imposition of sales tax "impair[s] federal uniformity in an area where federal uniformity is essential." *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 448, 453 (1979). Moreover, since Tennessee's sales taxes will be paid, in substantial part, by foreign steamship lines and container lessors, the decision below invites retaliation against domestic firms by our trading partners.

At the same time, the tax will both increase the cost of American exports and discourage the use of American containers, effects that will impose disproportionate burdens on American firms engaged in foreign commerce. Because more than $84 billion in American exports are carried in containers annually, the imposition of a "transit" fee on the transfer of containers will have a substantial impact on America's import and export trade. Further, approximately 25% of all containers, representing a market value of $2.5 billion, are owned by firms domiciled in the United States; state taxes on the transfer of these containers will put this crucial domestic industry at a significant competitive disadvantage.

Finally, this case presents recurring issues of considerable importance under the Foreign Commerce, Supremacy and Import-Export Clauses. The decision of the Tennessee Supreme Court disregards "sensitive matters of foreign relations and national sovereignty" recognized by the Court in *Japan Line*, 441 U.S. at 456, and conflicts directly with the Court's holding in *Richfield* and the Fifth Circuit's recent decision in *Louisiana Land & Exploration Co. v. Pilot Petroleum Corp.*, 900 F.2d 816 (5th Cir. 1990), cert. denied, 111 S. Ct. 248 (1990). In *Dept. of Revenue v. Ass'n of Washington Stevedoring Cos.*, 435 U.S. 734, 737 n.23 (1978), the Court explicitly reserved the Import-Export Clause issue present here. Further review accordingly is warranted.

I. APPLICATION OF A STATE SALES TAX TO INSTRUMENTALITIES OF FOREIGN COMMERCE IS INCONSISTENT WITH THE FOREIGN COMMERCE CLAUSE

Japan Line. In *Japan Line*, the leading case under the Foreign Commerce Clause, this Court invalidated a state ad valorem property tax on containers that were owned by foreign domiciliaries and used in foreign commerce. See 441 U.S. at 437. The Court observed that state taxes on foreign commerce, in contrast to parallel levies on interstate trade, pose both an "enhanced risk of multiple taxation" (*id.* at 446) and the prospect of "impair[ing] federal uniformity in an area where federal uniformity is essential." *Id.* at 448. See also *South Central Timber Development, Inc. v. Wunnicke*, 467 U.S. 82, 92 n.7 (1984). The Court accordingly held that an inquiry into the constitutionality of a state tax on foreign commerce has two parts:

> [A] court must * * * inquire, first, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation, and, second, whether the tax prevents the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.' If a state tax contravenes either of these precepts, it is unconstitutional under the Commerce Clause.

Japan Line, 441 U.S. at 451.[7] The Court later explained that a state tax "will violate the 'one voice' standard if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive." *Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 194 (1983).

Like *Japan Line*, this case involves a state tax on containers whose movements in the taxing jurisdiction "are essential to, and inseparable from, the containers' efficient use as instrumentalities of foreign commerce." 441 U.S. at 437. In distinguishing *Japan Line*—which it recognized would otherwise be controlling—the court below grounded its decision entirely on the legal conclusion that a state sales tax "is distinguishable from a direct *ad valorem* property tax" for purposes of the Foreign Commerce Clause. App., *infra*, 12a. In going on to hold that a sales tax is exempt from the requirements of the Clause, the court explained that "the transfer of containers is a discrete transaction, occurring only in Tennessee, which creates no risk of multiple international taxation." *Id.* at 14a (footnote omitted). As for the other concerns identified in *Japan Line*, the court similarly reasoned that none "are implicated by a sales tax on a discrete transaction occurring only in one jurisdiction." *Id.* at 16a.

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[7] A state tax on foreign commerce also must satisfy the separate test established in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), for the analysis of burdens on interstate commerce. See *Japan Line*, 441 U.S. at 451. At this point, it is not disputed that the Tennessee tax passes the *Complete Auto* test.

Sales Taxes and the Foreign Commerce Clause. This issue—whether sales and similar transaction taxes are inherently immune from challenge under the Foreign Commerce Clause—is a recurring one of great practical importance. While the Court has addressed the application of the Clause to state property taxes (in *Japan Line*) and apportioned net income taxes (in *Container Corp.*; see also *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425, 448 (1980)), it has reserved the question as to sales taxes. Holding in *Wardair Canada, Inc. v. Dept. of Revenue*, 477 U.S. 1 (1986), that the federal government had affirmatively permitted application of the Florida sales tax to aviation fuel sold to foreign carriers (see 477 U.S. at 3-4, 9-10, 12), the Court expressly noted that "nothing in this opinion should be understood to address[] whether, in the absence of these international agreements . [permitting state taxation], the Foreign Commerce Clause would invalidate Florida's tax." *Id.* at 13. That sales tax issue, which may arise frequently, warrants the Court's attention and is fairly presented in this case. Sales and use taxes, currently imposed by 45 States, are ubiquitous; if the decision below is left standing, many States surely will follow Tennessee's lead and apply their local taxes to containers and other instrumentalities of foreign commerce. Cf. *Japan Line*, 441 U.S. at 453 & n.19. And as the examples of *Wardair* and this case make clear, Foreign Commerce Clause issues involving sales taxes may appear in a wide range of contexts. The Court should grant review to settle the constitutionality of such taxes.

That is especially so because the decision below cannot be reconciled with the principles set down by this Court. In *Wardair*, Justice Blackmun, the only Member of the Court to reach the constitutional issue, flatly rejected reasoning of the sort relied upon by the court below, finding that "[t]he tax imposed in this case by Florida on fuel is indistinguishable, for Commerce Clause purposes, from the tax imposed by California on containers

in *Japan Line*." 477 U.S. at 18 (Blackmun, J., dissenting). That was the case, Justice Blackmun explained, because "other countries may react to Florida's tax with various retaliatory measures against United States cariers abroad, retaliation that 'of necessity would be felt by the Nation as a whole.'" *Id.* at 20, quoting *Japan Line*, 441 U.S. at 45. Similarly, the United States, whose views are entitled to considerable deference in this area (see *Container Corp.*, 463 U.S. at 195-196), took the position in *Wardair* that Florida's sales tax involved "the regulation of those aspects of foreign commerce which by their very nature require uniform national treatment." U.S. Br. in support of prob. jur., No. 84-902 at 9.

Risk of Multiple Taxation. These conclusions, which are compelled by the Court's decisions, apply with equal force to Tennessee's tax. At the outset, the state court's suggestion that duplicative taxation is impossible in the case of a transfer tax, because the taxable event occurs only in one jurisdiction, was far too facile. In fact, other nations may impose compensating use or similar taxes upon containers delivered in Tennessee; similarly, because liability for the Tennessee taxes arises from only one of several facets of a lease—the transfer of physical possession—a sales tax may be imposed in other nations on the same lease transaction (for example, by taxing the execution of the lease). As a matter of economic substance, such taxes would duplicate Tennessee's sales tax.[8]

[8] The court below relied (App., *infra*, 14a) on the Court's observation in *Wardair* that there was no prospect of duplicative taxation because the Florida tax was imposed on "a discrete transaction which occurs within one national jurisdiction only." 477 U.S. at 9. As the point was conceded by the taxpayer, however (see *ibid.*), the Court had no occasion to consider the prospect of compensating taxes in other nations. In fact, the special nature of the event taxed in *Wardair* made compensating levies impossible. First, as a matter of law, the prospect of double taxation of aviation fuel was precluded by a treaty that prohibits localities from taxing fuel "'on board an aircraft * * * on arrival' * * * [but] does not prohibit taxation of fuel purchased in that country." *Id.* at 10. Second, as a matter of fact, the United States carefully explained that, "far from being able to tax the event of sale, foreign nations could not purport to tax even the fuel itself, which typically will be consumed in international air space en route from the United States." U.S. Br. in support of prob. jur., No. 84-902, at 31. While the Court has formally left open in the interstate setting whether a State that imposes a compensating use tax is constitutionally compelled to provide a credit for sales tax paid elsewhere (see *Williams v. Vermont*, 472 U.S. 14, 23 n.7 (1985)), it seems plain that the taxes are equivalent. See *Henneford* v. *Silas Mason Co.*, 300 U.S. 577, 583-587 (1937); McCray, *Commerce Clause Sanctions Against Taxation on Mail Order Sales: A Re-Evaluation*, 17 Urb. Law. 529, 557 (1985).

Indeed, Tennessee recognizes this and provides an offset for such taxes paid to other States when *interstate* commerce is involved; no such credit is provided, however, when foreign commerce suffers multiple taxation. See Tenn. Code Ann. 67-6-313(f) (1989), -507 (1990). If applied by other nations, such taxes "'inevitably' [would lead] to double taxation." *Container Corp.*, 463 U.S. at 193. Whether the *risk* of such duplicative taxation is enough to invalidate a state tax is an important question that was expressly left open in *Japan Line*. 441 U.S. at 452 n.17.

The "One Voice" Test. As for the so-called "one voice" prong of the *Japan Line* test, the Court has explained that "[a] state tax on instrumentalities of foreign commerce may frustrate the achievement of federal uniformity in several ways." *Japan Line*, 441 U.S. at 450. In particular, "[i]f a novel state tax creates an asymmetry in the international tax structure, foreign nations disadvantaged by the levy may retaliate against American-owned instrumentalities present in their jurisdictions." *Id.* at 450. And so far as containers are concerned, the Court concluded in *Japan Line* that "[t]he desirability of uniform treatment of containers used exclusively in foreign commerce is evidenced by the [1956] Customs Convention on Containers." 441 U.S. at 452.

Here, the Tennessee tax is a novel one that "creates an asymmetry in international maritime taxation."

Japan Line, 441 U.S. at 453. While they impose general taxes on the lease of goods, *none* of our trading partners imposes a tax on the transfer overseas of containers owned by American domiciliaries.[9] Imposition of the Tennessee tax on transfers in this country of containers owned by foreign domiciliaries accordingly will invite retaliation.[10] See *ibid.* And there is a related area of concern here. While the legal incidence of the Tennessee tax falls on the container lessor, state law provides that the tax must be separately stated on the bill submitted to the lessee and "shall be collected by the retailer from the consumer insofar as it can be done." Tenn. Code Ann. 67-6-502. This obligation to collect the tax from the lessee is mandatory. See *Hooten v. Carson*, 209 S.W.2d 273, 275 (Tenn. 1948). Indeed, a seller or lessor who fails to collect the tax at the time of the transaction may bring an action against the purchaser or lessee for the amount due or paid. See *Sam Carey Lumber Co. v. Sixty-One Cabinet Shop, Inc.*, 773 S.W.2d 252, 254-55 (Tenn. App. 1989). As a consequence, Itel's foreign customers, who will bear the burden of the tax, may demand that their governments impose corresponding tax burdens on American shippers who lease containers overseas. Furthermore, foreign nations will be encouraged to impose an entirely new class of local taxes on container use and transfer.

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[9] The member countries of the European Community, for example, have adopted a uniform system of value added taxation upon the "supply of goods and services" and the "importation of goods." O.J. European Comm. (No. L 145) art. 2 (1977) (Sixth Directive, 77/388). The system's equivalent of a sales tax is the "output" tax; the equivalent of a use tax is the "input" tax. The leasing of goods is considered a taxable supply of services. *Id.* art. 6. The Community honors its members countries' obligations under the Customs Conventions by exempting the following from value added taxation: (1) imported goods which qualify for Customs duty exemptions; and (2) supplies of services directly linked to the transit or export of goods. *Id.* arts. 14(I)(c), 15(1). Further, the United States represented in *Japan Line* that "[a]ll the other nations have adhered to the international custom of allowing containers * * * to be introduced for the exclusive purpose of conducting [foreign] commerce free of all customs duties and general taxes." No. 77-1378, U.S. Br. at 15.

[10] In addition, if other States follow Tennessee's example, foreign owned containers "will be subjected to various degrees of multiple taxation, depending on which American ports they enter. This result, obviously, would make 'speaking with one voice 'impossible." *Japan Line*, 441 U.S. at 453.

Uniform National Policy. The court below also went astray in its bald assertion that a sales tax cannot interfere with essential uniformity by "hinder[ing] the policies embodied in the Customs Convention on Containers." App., *infra*, 16a. As explained more fully below, this Court has read the Container Convention to "reflect[] a national policy to remove impediments to the use of containers as 'instruments of international traffic.'" *Japan Line*, 441 U.S. at 453 (citation omitted). A tax that makes the transfer of containers more expensive damages that policy in precisely the same way as did the property tax at issue in *Japan Line*. Indeed, in closely analogous settings the Court has made clear that the difference between sales and property taxes is "of no importance, for imposition of either tax would detract from the benefit" conferred by federal policy. *R.J. Reynolds Tobacco Co. v. Durham County*, 479 U.S. 130, 142 n.10 (1986); see *Xerox Corp. v. Harris County*, 459 U.S. 145, 153 (1982) (distinction between a sales and property tax "without a legal difference").

Finally, the Tennessee law intrudes in an area "where federal uniformity is essential" by taxing the transfer of containers that are used to transport to other countries goods that are produced in Tennessee and other States. While benefitting Tennessee, the tax will increase the price both of containers originating in the United States and of the cargo exported in them. That will have "harmful effects on American industry and workers" by discouraging use of American ports and the consumption

overseas of American goods. *R. J. Reynolds Tobacco*, 479 U.S. at 145. Tennessee, "by its unilateral act, cannot be permitted to place these impediments before this Nation's conduct of its foreign relations and its foreign trade." *Japan Line*, 441 U.S. at 453.

For present purposes, it is immaterial that the container owner was domiciled abroad in *Japan Line* and is a domestic domiciliary here. The court below expressly declined to rely on this distinction (App., *infra*, 7a-8a); as a result, the only issue presented in this case is whether there is a necessary constitutional difference between sales and property taxes. A consequence of the court's decision, moreover, is that the State appears bound to apply its tax to foreign owners who transfer possession of their containers in Tennessee.[11] And because state law requires Itel to pass on the tax to its lessees, Tennessee effectively imposes its tax in substantial part on the 80% of Itel's customers that are domiciled in foreign countries (see Trial Tr. 31-33)—customers who, under state law, have no means of challenging the constitutionality of the levy. See *Beare Co. v. Olsen*, 711 S.W.2d 603, 605 (Tenn. 1986). Prospects of retaliatory treatment therefore are squarely presented by the tax at issue here.

Any suggestion that the substantial Foreign Commerce Clause problems presented by Tennessee's tax could be avoided by withholding enforcement of the tax against containers leased by foreign lessors would itself raise serious constitutional questions, as the court below recognized. App., *infra*, 7a-8a. This Court divided four-to-four on the constitutionality under the Commerce Clause of a state tax that gave preferential treatment to foreign over domestic commerce. *Sears Roebuck & Co. v. County of Los Angeles*, 449 U.S. 1119 (1981), affirming 85 Cal. App.3d 763 (Cal. Ct. App. 1978).[12] And Justice Powell, writing for the three Members of the *Container Corp.* Court who reached the question, subsequently concluded that a State cannot discriminate against a corporation domiciled in another State and "in favor of an overseas corporation" unless it receives "explicit congressional authorization." 463 U.S. at 203 (Powell, J., dissenting). See *id.* at 204 n.6. Indeed, in *Japan Line* itself the Court expressly reserved the question whether domestically owned instrumentalities of foreign commerce are subject to state taxation. 441 U.S. at 444 n.7. Without resolution of the issues left open in these decisions, Itel's domestic domicile must be deemed immaterial to the constitutionality of Tennessee's tax.

[11] The record establishes that at least one foreign container owner transfers containers to lessees in Tennessee. See App., *infra*, at Trial Tr. 89-90.

II. A STATE SALES TAX ON CONTAINERS USED EXCLUSIVELY IN FOREIGN COMMERCE VIOLATES THE CONTAINER CONVENTIONS

Clear Federal Directive. The Tennessee tax also is flawed for a closely related reason: it is flatly inconsistent with the "clear federal directive" (*Container Corp.*, 463 U.S. at 194) embodied in the Container Conventions and their implementing regulations. As the Court explained in *Container Corp.*, a problem of this sort calls for "a species of preemption analysis" (*ibid.*), which turns on whether the state tax "stands as an obstacle to the accomplishment and execution of the full purposes and objectives" of federal policy. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). Where the federal directive is designed to preclude interference with the international trade or foreign relations of the United States, this Court historically has been vigilant in setting aside inconsistent state taxes. See, *e.g.*, *Xerox Corp. v. Harris County*, 459 U.S. 145 (1982); *McGoldrick v. Gulf Oil*

[12] The California Supreme Court subsequently held that the differential tax violated the Commerce Clause. *Star-Kist Foods, Inc. v. Los Angeles*, 719 P.2d 987 (Cal. 1986), cert. denied, 480 U.S. 930 (1987).

Corp., 309 U.S. 414 (1940). Because these interests are at stake here—and, even more fundamentally, because the state court's departure from *Japan Line* validates a state tax that places the United States in violation of its international obligations—review by this Court is warranted.

The 1956 Convention, which was addressed by the Court in *Japan Line*, provided for the temporary admission of containers into the signatory states free of "all duties and taxes whatsoever chargeable by reason of importation" so long as they were used solely in foreign commerce and were subject to reexportation. 20 U.S.T. at 304. See *Japan Line*, 441 U.S. at 446 n.10, 453. The Convention was implemented by Treasury Department regulations designating containers "instruments of international traffic" (19 C.F.R. 10.41a(a)(1)) and by a statute excepting such instruments from application of the customs laws. 19 U.S.C. 1322(a). Pointing to this regime, the Court concluded in *Japan Line* that "[t]he desirability of uniform treatment of containers used exclusively in foreign commerce is evidenced by the Customs Convention on Containers. * * * The Convention reflects a national policy to remove impediments to the use of containers as 'instruments of international traffic.'" 441 U.S. at 452-453, quoting 19 U.S.C. 1322(a). The Court's conclusion that state taxation of containers was inconsistent with this policy was a central aspect of its holding. See 441 U.S. at 453.

Since that time, the international proscription on local regulation of containers has become considerably *stricter* with ratification of the 1972 Container Convention, which was joined by the United States in 1985. Adoption of the 1972 Convention was prompted by "the considerable increase in numbers of containers used in international traffic" and the "need both for simplifying Customs formalities and facilitating container transport." U.N. Doc. E.CONF. 59/2 (Feb. 22, 1971), at 1 (Note by the Secretariat). As the United States noted in its comment on the draft 1972 convention, the revision of the 1956 Container Convention was designed to "contribute significant economic benefits to the development and facilitation of international container traffic on a global basis." U.N. Doc. E.CONF. 59/16 (Nov. 26, 1971), at 2.

The preamble to the 1972 Convention thus affirms the treaty's purpose "to develop and facilitate international carriage by container." 988 U.N.T.S. 43, 44. And the 1972 Convention provides a broader and more precise description of proscribed taxes than did its predecessor, prohibiting the imposition of "Customs duties and all other duties, taxes, fees and other charges which are collected on, or in connection with, the importation of goods, but not including fees and charges limited in amount to the approximate cost of services rendered." *Ibid.* It also provides detailed and comprehensive regulations relating to the admission, use, design, and marking of containers. See *id.* at 45-74. These regulations are supplemented by the contemporaneously drafted International Convention for Safe Containers (39 U.S.T. 3707), which establishes safety standards, and by a network of bilateral treaties between the United States and its trading partners governing income taxation of the profits of container lessors.[13]

Pervasive Scheme of Regulation. Against this background, the Tennessee tax plainly is preempted, both by the plain terms of the Conventions, particularly the 1972 Convention, and by virtue of the pervasive scheme of federal regulation. A tax on the transfer of containers temporarily admitted to the United States as part of a continuous process of importation and exportation is one "in connection with" the import of goods—a conclusion that is evident when Tennessee's tax is contrasted with the narrow user fees that expressly are permitted by the

[13] See *Treasury Department's Model Income Tax Treaty of June 16, 1981*, Tax Treaties (CCH) ¶ 211 at 10,576 (1990) (for the avoidance of double income taxation).

Convention. This understanding also is confirmed by the failure of any party to the Convention to impose a tax such as the one at issue here. Cf. *Wardair*, 477 U.S. at 12. And, of course, the Tennessee tax plainly works as an "impediment[] to the use of containers as 'instruments of international traffic.'" *Japan Line*, 441 U.S. at 453 (citation omitted). Indeed, in *Japan Line* the United States pointed to the 1956 Convention as establishing that "disparate state laws offend a perceived need for federal uniformity" (No. 77-1378, U.S. Br. 27 n.20), explaining that "[a] state tax would frustrate accomplishment of the federal objective" (*id.* at 28) and therefore "conflicts with the spirit and design of the federal scheme." *Id.* at 29 (footnote omitted).

Any doubt about the preemptive effect of the Conventions is dispelled by the Court's decisions in *McGoldrick* and *Xerox*, which respectively invalidated state sales and property taxes on goods stored under bond in Customs bonded warehouses. Like the Container Conventions, the statutes governing such warehouses (the current versions of which appear at 19 U.S.C. 1555-1560) provide that goods may temporarily enter the United States free of Customs duties, so long as they are stored under bond in a designated facility; the goods may then be reexported or, upon payment of the duty, distributed in the United States. See *R. J. Reynolds Tobacco*, 479 U.S. at 133-134 n.3. In *McGoldrick* and *Xerox* the Court noted the policy behind the warehouse statutes of "encourag[ing] merchants here and abroad to make use of American ports." *Xerox*, 459 U.S. at 151. See *McGoldrick*, 309 U.S. at 427. And—although the statutory language in terms precluded the imposition only of Customs duties [14]—the Court held

[14] A Customs regulation in force at the time *McGoldrick* was decided provided that goods in bonded warehouses were not subject to the process of state courts and were exempt from taxation under the general laws of the States. See 309 U.S. at 426. As the Court noted in *Xerox*, however, the *McGoldrick* Court expressly declined to rely on this regulation in finding preemption. See 459 U.S. at 152, quoting 309 U.S. at 429. The regulation had been deleted by the time of the decision in *Xerox*; the Court held that "[t]he deletion * * * does not alter our conclusion that the ad valorem taxes here are pre-empted by the statutory scheme." 459 U.S. at 152-153 n.8.

that the state taxes were preempted in both cases because "the purpose of the Congressional regulation of the commerce would fail if the state were free at any stage of the transaction to impose a tax which would lessen the competitive advantage conferred on the importer by Congress." *McGoldrick*, 309 U.S. at 429. See *Xerox*, 459 U.S. at 153. In reaching this conclusion, the Court expressly found "no relevance" in the distinction between sales and property taxes. 459 U.S. at 153.

The court below offered two reasons for declining to follow *McGoldrick* and *Xerox*. First, it found the decisions inapposite because, while the warehouse statutes were designed to benefit American shippers and ports, "the Court in *Japan Line* found no Congressional intent to benefit container companies in the statutes regulating cargo containers." App., *infra*, 10a. But that reasoning is defective. The Court in *Japan Line* identified a closely related federal policy: *general* facilitation of the use of containers. See 441 U.S. at 152-153. Tennessee's sales tax frustrates federal policy in precisely the same way as did the state taxes at issue in *McGoldrick* and *Xerox*: the imposition of a state tax on the transfer of containers that enter and exit the United States in a continuous cycle of importation and exportation will "offset substantially the very benefits Congress intended to confer by remitting the duty." *Xerox*, 459 U.S. at 153 (footnote omitted).

The state court also found preemption inappropriate because, in its view, "Congress' regulation of cargo containers is less pervasive than its regulations of bonded warehouses." App., *infra*, 14a. This finding is incorrect; the relevant regulations (which were not so much as cited by the court below) and the Convention

itself impose elaborate requirements relating to the admission, operation, and design of containers that parallel those imposed on Customs warehouses.[15] But the court's observation also is beside the point: regardless of whether the container regulations are as detailed, the crucial factor here is that the Tennessee tax frustrates federal policy. Cf. *R. J. Reynolds Tobacco*, 479 U.S. at 148-149. *McGoldrick* and *Xerox* make clear that preemption is required in such circumstances.[16] Furthermore, the United

[15] See 1972 Convention art. 38, 988 U.N.T.S. at 45-46 (temporary admissions facilities and procedures); art. 9, *id.* at 46 (conditions on use of containers granted temporary admission); arts. 10, 11, *ibid.* (admission of parts and accessories); art. 12, *id.* at 47 (approval of containers used to transport goods under Customs seal); Annex 1, *id.* at 51, 52 (marking of containers); Annex 2, *id.* at 52 (obligation of container owners to provide detailed records concerning movement of temporarily admitted containers and to pay duties when conditions of admission not satisfied); Annex 3, *id.* at 52 (use of containers in internal traffic); Annex 4, *id.* at 52-61 (technical conditions on design and structure of containers); Annex 5, *id.* at 61-67 (procedures for approval of containers); 19 C.F.R. 113.66(a) (bond conditions); 19 C.F.R. Pt. 115 (procedures for approval and certification of containers). Compare 19 C.F.R. 19.1-19.6 (regulations for Customs warehouses). While it is true that goods in Customs warehouses remain under the supervision and control of Customs officers (see 19 C.F.R. 19.4; *Xerox*, 459 U.S. at 147, 148 & n.2), whereas containers do not, that is wholly a function of the practicalities of container operation; containers, of course, must move from place to place along with the goods they transport. That does not detract either from the pervasiveness of the container regulations or from the force of the policies underlying those regulations.

[16] The court below also semed to suggest that preemption is inappropriate because 19 U.S.C. 1322(a) excepts instrumentalities of foreign commerce only from the Customs laws; the court concluded that "[t]he regulations adopted pursuant to that statute, therefore, can go no further than to provide exceptions from federal customs duties." App., *infra*, 13a; see *id.* at 9a. In fact, however, the Convention itself, which of course has the force of federal law, expressly precludes a range of taxes in addition to Customs duties. In any event, the state court's observation hardly serves to distinguish *McGoldrick* and *Xerox*, which found preemptive force in statutes and regulations that in terms addressed *only* Customs duties. Indeed, the property tax disapproved in *Japan Line* as inconsistent with the

States took the position in *Japan Line* that the bonded warehouse provisions are "analogous" to the Convention (No. 77-1378, U.S. Br. at 25), concluding that "[t]he rationale of *McGoldrick* applies here as well." *Id.* at 27 (footnote omitted). This Court should intervene to bring state law into accord with federal policy.

III. A STATE TAX ON GOODS THAT ARE MOVING IN FOREIGN COMMERCE VIOLATES THE IMPORT-EXPORT CLAUSE

This case also presents another recurring issue that bears on the international trade of the United States: whether the Import-Export Clause invalidates state taxes that are imposed directly on imported or exported goods while they are in transit. The Court reserved that question in *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976), and in later decisions. The Fifth Circuit, in *Louisiana Land & Exploration Co. v. Pilot Petroleum Corp.*, 900 F.2d 816 (5th Cir. 1990), cert. denied, 111 S. Ct. 248 (1990), held that such a tax is an unconstitutional charge on exports in transit. The decision below, which cannot be reconciled with *Louisiana Land*, offers the Court an opportunity to resolve the issue.

Before *Michelin*, the Court invalidated all state taxes imposed on imported or exported goods contained in their original packaging. See *Michelin*, 423 U.S. at 282-283, discussing *Low v. Austin*, 80 U.S. (13 Wall.) 29 (1872). During that period, the Court decided *Richfield Oil Corp. v. State Board of Equalization*, 329 U.S. 69 (1946), which struck down a state sales tax on exported oil while in transit; the Import-Export Clause invalidated the tax because the transfer of possession of the oil "was a step in the export process." *Id.* at 84.

In *Michelin*, the Court adopted a new test to determine whether a nondiscriminatory state tax levied on imported

1956 Container Convention was no more a Customs duty than is the sales tax at issue here.

goods no longer in transit violates the Import-Export Clause. The test analyzes "the nature of the tax to determine whether it i[s] an 'Impost or Duty.'" *Department of Revenue v. Ass'n of Washington Stevedoring Cos.*, 435 U.S. 734, 752 (1978). Under the test, three policies must be considered: (1) the federal government must speak with one voice when regulating commercial relations with foreign governments; (2) import revenues should not be diverted from the federal government to States; and (3) interstate harmony might be disturbed unless seaboard States are prohibited from levying taxes on citizens of other States by taxing goods merely flowing through their ports. *Michelin*, 423 U.S. at 285-286.

In using its new approach to uphold the ad valorem property tax at issue in *Michelin*, however, the Court emphasized that the levy was imposed "on imported goods that are no longer in import transit." 423 U.S. at 286. See *id.* at 302 (goods "were no longer in transit"). In *Washington Stevedoring Cos.*, the Court noted this limitation on the *Michelin* holding and declined to resolve whether state taxes on goods in transit remain *per se* unconstitutional; the Court upheld a state tax on stevedoring services because "the taxation falls upon a service distinct from the goods and their value." 435 U.S. 757 (footnote omitted). The Court added that it did "not reach the question of the applicability of the *Michelin* approach when a State directly taxes imports or exports in transit," "prefer[ring] to defer decision until a case with pertinent facts is presented." *Id.* at 757 n.23. See *id.* at 755. Most recently, in *R. J. Reynolds*, the Court again "observed that in *Michelin* it limited its holding to the imported goods "'no longer in transit.'" 479 U.S. at 154 (citation omitted). The Court upheld the property tax there at issue because the imported material had "nothing transitory about it." *Id.* at 155.

In *Louisiana Land*, the Fifth Circuit answered the question reserved in *Michelin*, finding it fatal to a state

sales tax that the goods were in transit at the time the tax attached. The Fifth Circuit noted that "*Richfield* has never been overruled" (900 F.2d at 819) and that in *Michelin* "the Court limited its holding to taxes levied on goods no longer in transit." *Id.* at 820. The court therefore found the crucial question in the case before it to be "whether a state may directly tax imports or exports that are in transit." *Ibid.* It answered that question in the negative, concluding that "the Import-Export Clause was specifically intended to prevent the types of taxation involved in this case" (*ibid.*) and that the imposition of such taxes would disrupt foreign policy and discourage use of American ports. *Id.* at 821. The court accordingly held that the Import-Export Clause invalidates "a tax that is levied on the goods themselves while they are in transit." *Ibid.*

This case presents an identical issue.[17] Neither the State nor the court below denied that the containers subject to tax are themselves imports or exports, even though they also are used to transport other goods. That conclusion clearly is correct; the containers would, after all, be subject to federal import duties were it not for the Convention. And by definition, the containers are goods in transit. Indeed, their movements in Tennessee "are essential to, and inseparable from, the containers' efficient use as instrumentalities of foreign commerce." *Japan Line*, 441 U.S. at 437.

In nevertheless affirming the constitutionality of the state tax, the court below—in contrast to the Fifth Circuit in *Louisiana Land*—evidently viewed *Michelin* and *Washington Stevedoring Cos.* as holding the transitory character of the goods at issue to be immaterial. See App., *infra*, 16a-17a. The state court thus moved imme-

[17] The *Japan Line* court did not consider the taxpayer's argument that California's tax violated the Import-Export Clause because it disposed of the case under the Foreign Commerce Clause and the 1956 Convention. 441 U.S. at 439 n.4.

diately to the application of the *Michelin* test. In upholding the tax, the court found it crucial that "the transfer of possession of cargo containers is a discrete transaction"; that "Tennessee's tax only compensates the state for providing protective services, so the tax will not disturb harmony among the states"; and that "the indirect nature of the tax distinguishes it from the direct taxes held invalid in *Xerox* and *McGoldrick*." *Id.* at 18a.

It is manifest, however, that these observations cannot serve to distinguish *Richfield* and *Louisiana Land*, and the court below made no serious attempt to do so. Like this case, both of those decisions involved sales taxes on "discrete transactions." The taxes at issue there were no less "compensat[ion to] the state for providing protective services" than is the levy here. And the sales tax here is no less directly imposed on the subject goods than were the sales taxes invalidated in *Richfield*, *McGoldrick*, and *Louisiana Land*. Indeed, the Court has made clear that "[i]n *Richfield*, the tax fell upon the sale of goods and was overturned because the Court had always considered a tax on the sale of goods to be a tax on the goods themselves. * * * The sale had no value or significance apart from the goods." *Washington Stevedoring Cos.*, 435 U.S. at 756, n.21. That is true here as well.[18]

While review is waranted to resolve the issue reserved in *Michelin*, the decision below is wrong even on its own

[18] The court below also suggested that "[f]ederal import revenues are not affected, because Tennessee taxes only the lease proceeds on containers delivered here, not the value of the goods themselves." App., *infra*, 18a; see also *id.* at 8a. If this observation was meant to draw a distinction between sales and lease proceeds, in which the former are said to be related "to the value of the goods themselves" and the latter are not, it plainly is insupportable. Lease payments represent the value of the goods for the term of the rental. Indeed, Tennessee, like many other States, assesses the "true value" of tangible property for ad valorem tax purposes by capitalizing rental income. Tenn. Code Ann. 67-5-602(c)(1); *National Life & Accident Ins. Co. v. Keaton*, 1986 Westlaw 4846 (Tenn. App.).

terms. Because the containers are in transit to other nations, the Tennessee tax is "no more than [a] transit fee[] on the privilege of moving through a State" (*Michelin*, 423 U.S. at 290 (footnote omitted)); the Clause was intended to invalidate just such levies.[19] While the policies served by the Import-Export and Foreign Commerce Clauses are closely related (see *Japan Line*, 441 U.S. at 449-450 n.14), the former "states an absolute ban, whereas the [latter] merely grants power to Congress." *Washington Stevedoring Cos.*, 435 U.S. at 751. The application of a *per se* ban on state taxes imposed on American imports and exports while in transit serves the broader purposes of the Import-Export Clause by preventing States from taking advantage of their location to the detriment of American export trade. Indeed, the United States explained in *Japan Line* that the tax there at issue violated the Import-Export Clause because "the tax affects foreign relations, causes multiple tax burdens, and is levied on containers that are still part of foreign commerce and have never been formally entered into United States commerce." No. 77-1378, U.S. Br. at 32 n.23. The decision below discounted all of these consequences. Review by this Court accordingly is warranted.

[19] As a leading commentator has explained, a "basis for deciding in-transit tax cases under the new Import-Export Clause jurisprudence may be found in the purpose of the clause to prevent the seaboard States from exacting a tax on 'goods merely flowing through their ports.' A sales tax on goods being exported that is imposed at the point of delivery of title and possession of goods to the purchaser or his shipper for transport to the purchaser can be fairly regarded as such an exaction and, therefore, as a 'transit fee' that is repugnant to the Import-Export Clause." I J. Hellerstein, *State Taxation* § 5.4 at 189-190 (1983).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDICES

APPENDIX A

IN THE SUPREME COURT OF TENNESSEE
AT NASHVILLE

S/C No. 01-S-01-9005-CH-00038

ITEL CONTAINERS INTERNATIONAL CORPORATION,
Plaintiff/Appellant,

vs.

CHARLES E. CARDWELL,
Commissioner of Revenue, State of Tennessee,
Defendant/Appellee.

DAVIDSON CHANCERY

HON. ROBERT BRANDT, Chancellor

FOR PUBLICATION

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Affirmed.

ANDERSON, J.

OPINION

This case presents the question whether Tennessee may constitutionally impose a sales tax upon the transfer of possession in Tennessee of domestically-owned cargo containers used exclusively in international commerce. The Chancellor held that the imposition of such a tax is constitutionally permissible. We agree and affirm.

The facts were stipulated at trial as follows:

Itel Containers International Corporation ("Itel") is a Delaware corporation, with its principal place of business in San Francisco, California. Itel's principal business is the leasing of cargo containers which are used exclusively in international commerce. These containers are manufactured and purchased abroad by Itel, and enter the United States as instruments of international traffic. Itel has posted with the United States Customs Service a continuous bond which guarantees payment of all duties, taxes, or liquidated damages which could be assessed for a failure to comply with government regulations regarding Itel's withdrawal of any of the containers from international commerce.

Itel solicits container leases world-wide through its marketing offices located in numerous U.S. cities, but Itel conducts no marketing solicitation from any Tennessee location. Itel accepts leases of its containers only in its San Francisco office. All of its container leases restrict the use of the containers to international commerce. As a result of its international operations, Itel allows its customers to pick up and re-deliver containers at numerous locations around the world and in the United States.

In Tennessee, Itel receives, repairs, stores, and delivers containers at its terminal building in Memphis, and also, by contract with other independent terminals, at two other Tennessee locations. Itel is registered as a dealer with the Tennessee Department of Revenue, and collects

and remits sales and use tax on fees which it collects for repair services rendered in Tennessee.

The tax assessment complained of in this appeal is based upon Itel's leases of its cargo containers which were delivered in Tennessee to international carriers for international shipments. These leases began when the carriers took delivery of the containers at Itel's Tennessee locations.

Itel earns no revenue from the use of the containers while they are present in Tennessee, until they are picked up by the international carrier/lessee. The Department of Revenue computed the sales tax based upon its calculation of the average container days leased, and the average number of containers leased per month. Itel paid the assessment of tax, penalties, and interest under protest, and filed this action to recover those sums.

QUESTIONS PRESENTED

Itel challenges the validity of the tax assessment, I. on the statutory grounds that the mere transfer of possession of cargo containers in Tennessee is not a "sale" according to Tenn. Code Ann. § 67-6-102(23)(A), and that because its containers have not "become a part of the mass of property in this state," they are exempt from Tennessee sales tax pursuant to Tenn. Code Ann. § 67-6-211, II. alternatively, Itel aserts that Tennessee's imposition of a sales tax upon leases of federally bonded instruments of international traffic violates the Commerce, Supremacy, Import/Export, and Due Process clauses of the United States Constitution.

I.

STATUTORY AUTHORITY TO TAX

Itel argues that the mere transfer of possession of leased property in Tennessee is not a taxable event. The Tennessee Retailer's Sales Tax Act imposes sales tax on

the lease or rental of tangible personal property in this state. Tennessee Code of Annotated § 67-6-201 provides:

> It is declared to be the legislative intent that every person is exercising a taxable privilege who engages in the business of selling tangible personal property at retail in this state . . . or who rents or furnishes any of the things or services taxable under this chapter . . . or who leases or rents such property, either as lessor or lessee, within the state of Tennessee . . . .

"Lease or rental" is also included within the statutory definition of "sale:"

> "Sale" means *any transfer of* title or *possession*, or both, exchange, barter, *lease or rental*, conditional or otherwise, in any manner or by any means whatsoever of tangible personal property *for a consideration* . . . .

Tenn. Code Ann. § 67-6-102(23)(A) (emphasis added).

Itel cites *Magnavox Consumer Electronics v. King*, 707 S.W.2d 504 (Tenn. 1986), in support of its assertion that the legislature intended only to tax proceeds of leases entered into within Tennessee. In *Magnavox* we considered whether the use of vehicles by a lessee pursuant to a vehicle lease entered into in the state of Indiana were subject to Tennessee's use tax, Tenn. Code Ann. § 67-6-210. Itel's reliance on *Magnavox* could not be more misplaced, however, because in *Magnavox* we held that the use tax may be imposed upon lessees who lease property outside of this state for use in Tennessee.

No other authority is cited by Itel for its assertion, and we find that the statutory language quoted above is a clear declaration of the legislature's intent to tax the transfer of possession of tangible personal property in Tennessee, pursuant to lease agreements executed outside of Tennessee.

Itel argues that the delivery of its containers in Tennessee is exempt from taxation pursuant to Tenn. Code Ann. § 67-6-211, because its containers have not "come to rest" in Tennessee. Tennessee Code Annotated § 67-6-211 declares:

> It is the intention of this chapter to levy a tax on the sale at retail, the use, the consumption, the distribution, and the storage to be used or consumed in this state of tangible personal property after it has come to rest in this state and has become a part of the mass of property in this state.

We have held that this statute was intended "to extend the taxing power of the state of Tennessee to the fullest extent under the Commerce Clause," *Texas Eastern Transmission Corporation v. Benson*, 480 S.W.2d 905, 907 (Tenn. 1972), and that "where a tax does not constitute a violation of the Commerce Clause, no exemption is available under [the statute]," *Williams Rentals, Inc. v. Tidwell*, 516 S.W.2d 614, 615 (Tenn. 1974). Consequently, the next question to be resolved is whether the challenged tax assessment violates the Commerce Clause of the United States Constitution.

II.

UNITED STATES CONSTITUTIONAL AUTHORITY TO TAX

Initially, we note that the United States Supreme Court has held that California's imposition of its *ad valorem* property tax, assessed upon the value of identical cargo containers used exclusively in foreign commerce, violated the Commerce Clause. In *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 99 S. Ct. 1813 (1979), the Court held that

> the Constitution confers no immunity from state taxation, and . . . interstate commerce must bear its fair share of the state tax burden. Instrumentalities

> of interstate commerce are no exception to this rule . . . if the state tax is applied to an activity with a substantial nexus wtih the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state, no impermissible burden on interstate commerce will be found. *Complete Auto Transit v. Brady*, 430 U.S. 274, 279, 97 S. Ct. 1076, 1079 (1977).

441 U.S. at 444-45, 99 S. Ct. at 1819 (other citations omitted). The Court assumed that "if the containers were instrumentalities of interstate commerce, *Complete Auto* would apply and be satisfied . . . ." 441 U.S. at 445, 99 S. Ct. at 1820.

Next, however, the Court held that Japan Line's containers "are instrumentalities of foreign commerce, both as a matter of fact and as a matter of law," 441 U.S. at 445-446, 99 S. Ct. at 1820, and that when a state seeks to tax the instrumentalities of foreign commerce, rather than of interstate commerce,

> a court must also inquire, first, whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation, and, second, whether the tax prevents federal government from speaking with one voice when regulating commercial relations with foreign governments. If a state tax contravenes either of these precepts, it is unconstitutional under the Commerce Clause.

Japan Line, 441 U.S. at 451, 99 S. Ct. at 1823. Applying this test, the Supreme Court held that California's imposition of its property tax upon Japanese-owned shipping containers violated the Commerce Clause because the tax "results in multiple taxation of the instrumentalities of foreign commerce," and the tax "prevents this nation from speaking with one voice in regulating foreign trade." *Japan Line*, 99 S. Ct. at 1823.

Itel's containers, like Japan Line's containers, are instrumentalities of foreign commerce. The United States is a signatory to at least two international agreements concerning these containers. The Customs Convention on Containers [1] grants containers "temporary admission free of import duties and import taxes and free of import prohibitions and restrictions," provided they are used solely in foreign commerce and subject to re-exportation. Japan and the United States are signatories to a Bilateral Tax Convention [2] which, in order to prohibit double taxation of cargo containers, provides that

> income derived by *a resident of a contracting state* . . . *from the* use, maintenance, and *lease of containers* and related equipment . . . in connection with the operation in international traffic of ships or aircraft . . . is exempt from tax in the *other* contracting state."

Id. (emphasis added).

However, two features distinguish this case from *Japan Line*: First, unlike Japan Line, Ltd., Itel is a domestic American corporation, and the lease of its containers delivered in Tennessee are not taxed abroad; thus, the sales tax imposed by Tennessee creates no multiple international taxation in fact. The *Japan Line* Court recognized that foreign-owned shipping containers are distinguishable from domestically-owned containers, for the Court stated: "[W]e do not reach questions as to the taxability . . . of domestically-owned instrumentalities engaged in foreign commerce." *Japan Line*, 99 S. Ct. at 1819, fn. 7. Second, *Japan Line* concerned a direct ad valorem property tax on the value of the containers, while Itel challenges the validity of a sales tax assessed upon

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[1] 20 U.S.T. 301, 304, T.I.A.S. No. 6634 (1969).

[2] Convention between the United States of America and Japan for the Avoidance of Double Taxation (Bilateral Tax Convention), March 8, 1971 [1972], 23 U.S.T. 967, 1084-85, T.I.A.S. No. 7365.

the proceeds of leases of containers delivered in Tennessee. Since a state tax which discriminates against domestically-owned containers by exempting foreign-owned containers raises serious Equal Protection problems, we decline to consider the domicile of the owner of the containers as relevant.

As a threshold question, therefore, we consider whether the property tax held invalid in *Japan Line* is distinguishable from the sales tax assessed against Itel for the purpose of determining the constitutionality of the tax. Itel insists, of course, that the two taxes are not distinguishable, citing *Xerox Corporation v. Harris County, Texas*, 459 U.S. 145, 103 S. Ct. 523 (1982), *McGoldrick v. Gulf Oil Corporation*, 309 U.S. 414, 60 S. Ct. 64 (1940), *Ritchfield Oil Corp. v. State Board of Equalization*, 329 U.S. 69, 67 S. Ct. 156 (1946), and *Louisiana Land & Exploration Co. v. Pilot Petroleum Corp.*, 900F.2d 816 (5th Cir. 1990), as authority.

In *Ritchfield* and *Louisiana Land*, the Supreme Court and the 5th Circuit Court of Appeals, respectfully, found that sales taxes, like property taxes, violate the Import/Export Clause when imposed directly on goods destined for export. Because Tennessee's tax on container leases is not a direct tax on the value of goods destined for export, however, those cases are unpersuasive.

In *Xerox* and *McGoldrick*, the Supreme Court held that both property taxes and sales taxes assessed upon goods held in government-bonded warehouses violated the Supremacy Clause,[3] because "Congress intended to make customs-bonded warehouses federal enclaves free of state taxation." Accordingly, the Court held that "state property taxes on goods stored under bond in a customs warehouse

[3] "This Constitution, and the laws of the United States . . . shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the Constitution or laws of any state to the contrary notwithstanding." U.S. Const. art. VI, cl. 2.

are pre-empted by Congress' comprehensive regulation of customs duties." The Court found it

> unnecessary . . . to consider whether, absent congressional regulation, the taxes here would pass muster under the Import-Export Clause or the Commerce Clause.

Xerox, 459 U.S. at 154, 103 S. Ct. at 528.[4]

The Federal Customs Warehouse statutes, 19 U.S.C. §§ 1555 and 1557, differ significantly from the statute regulating cargo containers, 19 U.S.C. § 1332. While in bonded warehouses, imported goods are in the joint custody and continuous control and supervision of customs officers of the United States Customs Service and the warehouse proprietor. 19 U.S.C. § 1555(a). "Detailed regulations control every aspect of the manner in which the warehouses are to be operated." *Xerox*, 459 U.S. at 150, 103 S. Ct. at 526; *see* 19 C.F.R. §§ 19.1-19.6 (1982). In contrast, the statute "regulating" cargo containers merely provides that "instruments of international traffic . . . shall be granted the customary exceptions from the application of the *customs* laws." 19 U.S.C. § 1322(a) (emphasis added). Cargo containers are neither under the supervision nor in the custody of customs officers.

Clearly, Congress has the power to prohibit state sales taxes on cargo container leases, in order to benefit cargo container companies. In *Xerox*, the Court explicitly held that the customs-bonded warehouse statutes were in-

[4] The broad holdings of *Xerox* and *McGoldrick* have since been limited to provide a prohibition of state taxation only of goods destined for export. In *R.J. Reynolds Tobacco v. Durham County, N.C.*, 479 U.S. 130, 107 S. Ct. 499 (1986), the Court stated:

> It is difficult . . . to believe that the purposes in forming the customs-bonded warehouse scheme identified by the Court in *Xerox* would be disserved by the imposition of *ad valorem* property taxes on Reynold's imported tobacco.

Id., 479 U.S. at 144, 107 S. Ct. at 509.

tended by Congress "to stimulate business for American industry and work for Americans." *Xerox*, 459 U.S. at 451, 103 S. Ct. at 526. In both *Xerox* and *McGoldrick*, the Court found that it would be incompatible

> with the comprehensive scheme Congress enacted to effect [its] goals if the states were free to tax such goods while they were lodged temporarily in government-regulated bonded storage in this country. . . . First, Congress sought, in the statutory scheme reviewed in *McGoldrick*, to benefit American industry by remitting duties otherwise due. The import tax on crude oil was remitted to benefit oil refiners employing labor at refineries within the United States, whose products would not be sold in domestic commerce. [In *Xerox*], the remission of duties benefited those shippers using American ports as trans-shipment centers. Second, the system of customs regulation is as pervasive for the stored goods in [*Xerox*] as it was in *McGoldrick* for the refined petroleum. In both cases, the imported goods were segregated in warehouses under continual federal custody and supervision. Finally, the state tax was large enough in each case to offset substantially the very benefits Congress intended to confer by remitting the duty.

Xerox, 459 U.S. at 151-53, 103 S. Ct. at 527. In contrast, the Court in *Japan Line* found no Congressional intent to benefit container companies in the statutes regulating cargo containers. In the absence of any such Congressional intent, *Xerox* and *McGoldrick* support the conclusion that Congress has not preempted state sales taxes on the transfer of possession of cargo containers. Therefore, nothing in those cases persuades us that sales taxes are indistinguishable from property taxes.

The United States Supreme Court has held that it "was not the purpose of the Commerce Clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of

doing business," *Complete Auto*, 430 U.S. at 288, 97 S. Ct. at 1079, and the Court has endorsed that proposition in the international commerce context. In *R.J. Reynolds Tobacco v. Durham County, N.C.*, 479 U.S. 130, 107 S. Ct. 499 (1986), the Supreme Court recognized that "since this imported tobacco receives the same local governmental services, such as police and fire protection, as domestic tobacco, [if the tax is invalidated] local taxpayers would be forced to provide a subsidy in excess of a million dollars to Reynolds." 479 U.S. at 146, 107 S. Ct. at 510. Similarly, in *Department of Revenue v. Association of Washington Stevedoring Company*, 435 U.S. 734, 747, 98 S. Ct. 1388, 1396 (1978), the Supreme Court also held that "the Commerce Clause balance tips against the tax only when it unfairly burdens commerce by exacting more than a just share from the interstate [5] activity." The Court then weighed the state's interest in exacting from international commerce "its fair share of the cost of state government" against the burden imposed by the tax on international commerce, and concluded that Washington state's "business and occupation tax" on the discrete activity of loading and unloading ships engaged in interstate and international commerce did not violate the Commerce Clause. *Washington Stevedoring*, 435 U.S. at 748, 87 S. Ct. at 139d.

Moreover, the Supreme Court has recently upheld a state sales tax which burdened foreign commerce. In *Wardair Canada, Inc. v. Florida Department of Revenue*, 477 U.S. 1, 106 S. Ct. 2369 (1986), the Court applied its *Japan Line* test to determine that Florida's imposition

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[5] *Washington Stevedoring* predates *Japan Lines*, so the Court made no distinction between interstate and foreign commerce in its Commerce Clause analysis. Nevertheless, the holding of *Washington Stevedoring* applies to both interstate and foreign commerce, and the case was cited with approval in *Japan Line*, 441 U.S. at 444, 99 S. Ct. at 1819.

of a sales tax on jet fuel sold to international carriers did not violate the Commerce Clause. Thus, while sales taxes which burden foreign commerce have been upheld (*Wardair*) and a "Business and Occupation" tax on the service of loading and unloading goods in foreign commerce has been upheld (*Washington Stevedoring*) never has a direct *property* tax on goods still in international commerce been upheld. Tennessee's sales tax on the transfer of possession of containers used to move goods in foreign commerce is more analogous to a sales tax on fuel used to move passengers in foreign commerce, and to an occupation tax on the activity of loading and unloading cargo in foreign commerce, than to the direct *ad valorem* property tax imposed by California on Japan Line's cargo containers.

We conclude, therefore, that the sales tax assessed against Itel is distinguishable from a direct *ad valorem* property tax, and we hold that *Japan Line*, while instructive of the appropriate Commerce Clause analysis, is not dispositive of this case. Consequently, we return to the facts of this case and proceed to apply the *Japan Line* test to those facts.

A. THE COMMERCE CLAUSE [6]

The first step in *Japan Line*'s Commerce Clause analysis consists of *Complete Auto*'s four-fold requirements. We are persuaded that Itel's containers have a "substantial nexus" with Tennessee, since they are present within the state at the time of transfer of possession to each lessee, and since the containers are in the custody of Itel's employees and agents in Tennessee. Moreover, the tax is "fairly apportioned," since it is levied only on the

[6] "Congress shall have power . . . to regulate commerce with foreign Nations, and among the several states . . . ." U.S. Const. art. I, § 8, cl. 3.

proceeds of leases pursuant to which the lessee takes delivery in Tennessee. The tax does not "discriminate," since it falls evenhandedly on all leased personal property in the state; and finally, the tax is "fairly related to the services provided by [Tennessee], services that include not only police and fire protection, but also the benefit of a trained work force and the advantages of a civilized society." *Japan Line*, 441 U.S. at 445, 99 S. Ct. at 1820.

Itel argues that federal customs regulations, specifically 19 C.F.R. § 1041A(c) and (d), require that bonded cargo containers are to be treated as having never entered the United States. Therefore, since Itel's containers have no "presence" in Tennessee for U.S. Customs purposes, they may not be taxed because the "nexus test" of *Complete Auto* is not satisfied. Essentially, this is a variation of Itel's preemption and Supremacy Clause argument.

The federal statute pursuant to which the customs regulations were adopted, 19 U.S.C. § 1322(a), provides merely that "instruments of international traffic . . . shall be granted the customary exceptions from the application of the *customs* laws." (Emphasis added.) The regulations adopted pursuant to that statute, therefore, can go no further than to provide exceptions from federal customs duties. Because Tennessee's sales tax is not a federal customs duty, the customs statute and regulations are inapposite. Cargo containers bonded by the customs agency of the United States Treasury Department may well not be "present" in Tennessee for U.S. Customs purposes; but we hold the Itel's containers are present in the state of Tennessee for Tennessee sales tax purposes.[7]

[7] This disposes also of Itel's argument that the sales tax violates the Due Process Clause of the Fourteenth Amendment, which has been construed to permit state taxation on the basis of "the habitual employment of . . . property within the state." *Braniff Airways v. Nebraska State Board of Eq. & A.*, 347 U.S. 590, 601, 74 S. Ct. 757, 764 (1954) (citation omitted).

Williams Rentals, Inc. v. Tidwell, supra, 516 S.W.2d 614 (Tenn. 1974).

Moreover, the same argument was made and disposed of *R.J. Reynolds, supra*, 479 U.S. at 156, 107 S. Ct. at 515, in the context of goods stored in a government-bonded warehouse. Because we have found that Congress' regulation of cargo containers is less pervasive than its regulation of bonded warehouses, the argument that Congress has preempted state taxation must fail here as well.

We hold that Tennessee's sales tax meets the four-fold requirements of *Complete Auto*. Therefore, we proceed next to consider the additional two-part test articulated in *Japan Line* for determining whether a state tax on the instrumentalities of foreign commerce violates the Commerce Clause.

The first such question is whether the tax creates an enhanced risk of multiple international taxation. In *Wardair Canada, Inc. v. Florida Department of Revenue*, 477 U.S. 1, 106 S. Ct. 2369 (1986), *supra*, the Court summarily dismissed the possibility that a sales tax on jet fuel sold to international carriers created an enhanced risk of multiple international taxation:

> [T]here is no threat of multiple international taxation in this case, since the tax is imposed only upon . . . a *discreet transaction* which occurs within one national jurisdiction only.

Id., 477 U.S. at 9, 106 S. Ct. at 2373 (emphasis added).

Other nations very well may adopt similar taxes on the transfer of possession of leased containers within their taxing jurisdictions. However, we hold that the transfer of possession of cargo containers in Tennessee is a discrete transaction, occurring only within Tennessee, which creates no risk of multiple international taxation.[8]

[8] The fact that other jurisdictions might tax other transactions involving these containers is irrelevant. For example, other nations may impose landing fees on Wardair Canada's jets, or sales taxes on the passenger tickets; this clearly is not what is meant by "multiple international taxation" in *Wardair* or *Japan Line*, or by "double taxation" in the Bilateral Tax Convention, *supra*, at fn. 3.

The second test for validity of state taxation of instruments of foreign commerce articulated in *Japan Line* is whether the tax "prevents the federal government from speaking with one voice when regulating commercial relations with foreign governments." In *Department of Revenue v. Association of Washington Stevedoring Companies, supra*, 435 U.S. 734, 98 S. Ct. 1388 (1978), the Court held that:

> the assessments in this case are only upon business conducted entirely within Washington. No foreign business or vessel is taxed. Respondents, therefore, have demonstrated no impediment posed by the tax upon the regulation of foreign trade by the United States.

Id., 435 U.S. at 754, 98 S. Ct. at 1401. Likewise, Itel has demonstrated no impediment posed by Tennessee's tax upon the regulation of foreign trade by the U.S. government.

In *Japan Line*, the Court identified three reasons for its elaborate Commerce Clause analysis:

> A state tax on instrumentalities of foreign commerce may frustrate the achievement of federal uniformity in several ways. If the state imposes an apportioned tax, international disputes over reconciling apportionment formulae may arise. If a novel state tax creates an asymmetry in the international tax structure, foreign nations disadvantaged by the levy may retaliate against American-owned instrumentalities present in their jurisdictions. Such retaliation of necessity would be directed at American transportation equipment in general, not just that of the taxing state, so that the nation as a whole would

> suffer. If other states followed the taxing state's example, various instrumentalities could be subject to carrying degrees of multiple taxation, a result that would plainly prevent this nation from speaking with one voice in regulating foreign commerce.

Japan Line, 441 U.S. at 450-51, 99 S. Ct. 1822-23. None of these concerns are implicated by a sales tax on a discrete transaction occurring only in one jurisdiction. *Wardair*, *supra*; *Washington Stevedoring*, *supra*.

Because Tennessee's sales tax is imposed upon the discrete transaction of the transfer of possession of leased cargo containers in Tennessee, we find that the sales tax will not hinder the policies embodied in the Customs Convention on Containers, impair uniformity where essential, or prevent the Federal Government from speaking with one voice when regulating commercial relations with foreign governments. Consequently, we hold that the tax assessed against Itel is not prohibited by the Commerce Clause.

B. THE IMPORT/EXPORT CLAUSE [9]

Relying on *Richfield Oil Corp. v. State Board of Equalization*, 329 U.S. 69, 67 S. Ct. 156 (1946), Itel also contends that the Tennessee sales tax violates the Import/Export Clause.

> *Richfield* has never been overruled by the United States Supreme Court. However, in *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 96 S. Ct. 535 (1976), the Court initiated a new approach to the Import/

[9] "No state shall, without the consent of the congress, lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws; and the net produce of all duties and imposts, laid by any state on imports or exports, shall be for the use of the treasury of the United States; and all such laws shall be subject to the revision and control of the congress." U.S. Const. art. 1, § 10, cl. 2.

> Export Clause. . . . The *Michelin* Court focused on the nature of the [state] tax. Specifically, the Court outlined three policies that were to be served by the Clause.
>
> First, the federal government must speak with one voice when regulating commercial relations with foreign governments . . . . Second, import revenues were to be the major source of revenue for the federal government and should not be diverted to the states. Finally, harmony among the states might be disturbed unless seaboard states, with their crucial ports of entry, were prohibited from levying taxes on citizens of other states by taxing goods merely flowing through their ports to the other states not situated as favorably geographically. *Michelin*, 423 U.S. at 285-86, 96 S. Ct. at 540-41.

Louisiana Land & Exploration v. Pilot Petroleum, 900 F.2d 816, 819 (5th Cir. 1990).

In *Washington Revenue Dept. v. Stevedoring Association*, *supra*, 435 U.S. 734, 98 S. Ct. 1388 (1978), the Court applied the *Michelin* three-prong policy test, and found that none of those policies were threatened by Washington's business and occupation tax on the discrete service of loading and unloading ships in international commerce. Specifically, the federal government's ability to conduct foreign policy was not affected, because the tax was assessed against all businesses, upon discrete transactions occurring wholly within the state. Federal import revenues were not affected, because Washington taxed only the value of the loading and unloading of the goods, not the value of the goods themselves, and since the tax only compensated the government for providing protective services, it would not disturb harmony among the states. Most important to the Court was the indirect nature of the tax, the fact that the tax did not relate to the value of the goods, and the fact that the tax was applied to discrete services provided wholly within the state.

We have carefully considered the "one voice" test as part of our Commerce Clause analysis, above, and concluded Tennessee's tax meets this test. Like the business of stevedoring, the transfer of possession of cargo containers is a discrete transaction which does not impair the federal government's ability to speak with one voice in its conduct of foreign policy.

Federal import revenues are not affected, because Tennessee only taxes the lease proceeds on containers delivered here, not the value of the goods themselves. Tennessee's tax only compensates the state for providing protective services, so the tax will not disturb harmony among the states. Moreover, the indirect nature of the tax distinguishes it from the direct taxes held invalid in *Xerox* and *McGoldrick*. For these reasons, we hold that Tennessee's sales tax, as applied to the transfer of possession of cargo containers in Tennessee, does not violate the Import/Export Clause.

CONCLUSION

We have held that the Tennessee Department of Revenue has statutory authority to tax the transfer of possession of cargo containers in Tennessee, and that the imposition of that tax upon Itel does not violate the Commerce, Import/Export, Supremacy, or Due Process Clauses of the United States Constitution. Consequently, the judgment of the Chancellor is affirmed. Costs are taxed to the appellant.

/s/ E. Riley Anderson
E. RILEY ANDERSON
Justice

Concur:

Reid, C.J.
Drowota, O'Brien, and Daughtrey, JJ.

APPENDIX B

IN THE CHANCERY COURT FOR THE
STATE OF TENNESSEE
20TH JUDICIAL DISTRICT
DAVIDSON COUNTY
PART THREE

No. 88-3479-III

ITEL CONTAINERS INTERNATIONAL CORPORATION

vs.

CHARLES E. CARDWELL,
Commissioner of Revenue, State of Tennessee

[Filed Dec. 20, 1989]

MEMORANDUM

This case is before the Court on the plaintiff taxpayer's suit for refund of taxes, penalties, and interest paid to defendant Tennessee Department of Revenue. At issue is whether leases on overseas cargo containers distributed in Tennessee should be subject to taxation under the Retailers' Sales Tax Act, T.C.A. § 67-6-101, *et seq.*

The plaintiff, Itel Containers International Corporation, a Delaware corporation based in San Francisco, leases cargo containers to steamship carriers for overseas shipments. Itel enters its leases through two types of transactions: shipper pool arrangements and Master

Interchange ("MI") agreements.* With shipper pool arrangements, shippers intending to use overseas carriers pick up empty cargo containers free of charge from Itel at regional locations, then load and transport them to the port of exit. Shipper pool leases between Itel and the steamship carriers for the containers do not begin until the containers arive at port. MI agreements permit the carriers themselves to reserve cargo containers for later use. These leases begin when the carriers take delivery of the containers at the regional locations.

Itel has several container pickup locations in Tennessee, including its own terminal and storage depots owned and operated by third parties. The Department claims that Itel owes state sales tax on any lease of cargo containers distributed to either shippers and carriers from these pickup sites in the state.

Under the Retailers' Sales Tax Act, a taxable sale is defined in part as ". . . any transfer of title or possession, or both, exchange, barter, lease or rental, conditional, or otherwise, in any manner or by any means whatsoever of tangible property for a consideration. . . . T.C.A. § 67-6-102(23)(A). The Department argues that this definition of a taxable sale so long as Itel's cargo both shipper pool and MI lease agreements fall within containers change hands in Tennessee as part of their leasing arrangements.

Since it is the transfer of possession for consideration that is being taxed by Tennessee, the difference in the parties taking delivery of the containers in the state under the two types of lease transactions calls for a distinction in tax treatment. With shipper pool arrangements, the taxable event under T.C.A. § 67-6-102(23)(A), transfer of possession for consideration, takes place

* A third type of taxed transaction, the short term lease, is similar to a MI lease in most respects, and will be included with MI leases for purposes of discussion.

at the port of exit when the containers are turned over to the carriers. It is at port that the carriers' control over the containers and their obligation to pay under the lease begin. The Retailers' Sales Act, therefore, would not apply to these transactions since they occur out of state. Any taxes paid by Itel for leases under shipper pool arangements should be refunded by the Department.

The MI agreements, however, provide for direct release of the containers to the carriers themselves in Tennessee. These transactions fall squarely within the definition of a taxable sale, since transfer of possession from Itel to the leasing parties is completed in the state. Insofar as Itel has paid taxes, interest, and penalties on its MI lease agreements, Itel is not entitled to any refund.

In reaching this decision, the Court finds no intrusions on international commerce. *See* U.S. Const. art. I, section 8, cl 3. *See also* T.C.A. § 67-6-313(a). Businesses are not relieved of their just share of state tax burden simply because they are engaged in interstate commerce. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 288, 97 S. Ct. 1076, 1083, 51 L. Ed. 2d at 326, 336-37 (1977). A state may tax any business activity having a substantial connection with that state, so long as the tax is apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state. *Id.* at 279, 97 S. Ct. at 1079, 51 L. Ed. 2d at 331. The same rule applies to international commerce. *Japan Line, Ltd. v. County of Los Angeles*, 44 U.S. 434, 444-445, 99 S. Ct. 1813, 1819, 60 L. Ed. 2d 336, 345 (1979). The Tennessee tax is justified under these criteria.

Itel located cargo container storage facilities in this state for the business advantage of regional deliveries. This connection with the state is a sufficient threshold for tax liability to Tennessee. Further, Itel's advantage of location in Tennessee is realized when it earns the right to payment by delivering over its containers to leasing

customers in this state. It is logical that this should also be the event being taxed by to Tennessee. The state tax goes no further than this portion of Itel's business. There are no discriminatory effects on international commerce by taxing Itel since the tax assessed on MI leases is no different from the tax assessed by the state whenever any goods change hands for consideration in Tennessee. Itel enjoys the economic benefits of locating part of its operations in Tennessee as well as the protections the state provides while its containers are stored here. Itel is simply being asked to pay for what it is getting.

None of the additional factors suggesting a burden on international commerce in *Japan Line* are present with Tennessee's sales tax on Itel's MI lease transactions. *See* 44 U.S. at 451-53, 99 S. Ct. at 1823-24, 60 L. Ed. 2d at 350. In that case, the federal government's interest in "speaking with one voice" regarding matters of foreign commerce was affected by several local governments' decision to place an ad valorem property tax on Japanese-owned cargo containers temporarily in this county. The same cannot be said for Tennessee's decision to place a sales tax on all transfers of leased property in the state, including cargo containers, since the tax is on a transaction and not specifically on an item used for carrying on foreign trade. It is the value of doing business in this state that is being taxed, not the value of the cargo containers. The Court finds no impairment of uniform trade regulation by the Tennessee sales tax.

Moreover, none of the risks of multiple taxation identified in *Japan Line* can result from taxing transfers of possession of leased goods. It is a one-time event in a lease that can only occur in one taxing jurisdiction. Since Itel is a United States corporation enjoying the benefits of transferring cargo in containers Tennessee, it is Tennessee's prerogative to tax this activity.

The Court finds that Itel is entitled to a refund of taxes, penalties and interest attributable to taxes levied against its leases under shipper pool arrangements only. Counsel for Itel should submit the judgment order. Costs are assessed to the defendant.

/s/ Robert S. Brandt
ROBERT S. BRANDT
Chancellor

December 20, 1989

cc: James C. Gooch
Michael D. Sontag
Daryl J. Brand
Philip W. Collier

IN THE CHANCERY COURT
FOR DAVIDSON COUNTY, TENNESSEE
20th JUDICIAL DISTRICT
PART III

No. 88-3479-III

ITEL CONTAINERS INTERNATIONAL CORPORATION

v.

CHARLES E. CARDWELL
Commisisoner of Revenue, State of Tennessee

[Order Filed & Entered Feb. 23, 1990; Minute Book 56, Page 241]

FINAL ORDER

This case was tried on November 29, 1989. Upon the pleadings, the stipulations of the parties, the testimony of plaintiff's witnesses presented at trial, exhibits introduced at trial, the briefs and arguments of counsel and the entire record and after consideration of all the evidence presented, the Court, on December 20, 1989, announced its findings of fact and conclusions of law in a Memorandum, filed with the Clerk and Master on the same date, and which is incorporated herein by reference.

The Court found that the parties had agreed upon a revised assessment, which reduced the amount in dispute in this case from the sum of $382,465.00 in tax, penalty, and interest paid by Itel to a revised total of $259,504.00 in tax, penalty, and interest, and that the Department of

Revenue had agreed to refund to Itel the difference between those amounts, i.e., $122,961.00. In addition, the Court found that the parties had agreed to recompute the assessment to account for a shift in one of the audit sample test periods from March 1985 period originally sampled in the audit to a period of February 15 to March 15, 1985 which recomputation further reduced the amount in dispute in this case to the sum of $238,894.00 in tax, penalty, and interest and that the Department of Revenue had agreed to refund to Itel $20,610.00 (i.e. the difference between $259,504.00 — $238,894.00).

After trail, and as set forth in the Memorandum, the Court found that (i) Itel is entitled to a refund from the State of Tennessee of taxes, penalty and interest attributable to taxes levied against its leases under shipper pool arrangements in the amount of $80,882.00, and (ii) all master interchange agreements which provide for the delivery of the containers to the lessees' carriers themselves in Tennessee fall within the definition of taxable sale and insofor as Itel has paid taxes, interest and penalties on its master interchange lease agreements, it is not entitled to any refund. Therefore, the revised assessment of $158,012.00 in tax penalty and interest attributable to those transactions is sustained.

IT IS THEREFORE ORDERED, that judgment is entered in favor of Itel and against the State of Tennessee in the amount of $224,453.00 plus interest pursuant to T.C.A. § 67-1-1803(b) and that the costs of this cause are taxed against the State of Tennessee.

Entered this — day of ——, 1990.

/s/ Robert S. Brandt
ROBERT S. BRANDT
Chancellor

Approved for entry:

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State of Tennessee

APPENDIX C

IN THE CHANCERY COURT FOR
DAVIDSON COUNTY, TENNESSEE

No. 88-3479-III

ITEL CONTAINERS INTERNATIONAL CORPORATION
Plaintiff

v.

CHARLES E. CARDWELL
Commissioner of Revenue
State of Tennessee
Defendant

[Filed Nov. 27, 1989]

STATEMENT OF STIPULATED FACTS

1. This is a civil action brought by Itel Containers International Corporation ("Itel") against the Commissioner of Revenue to recover the sum of $382,465.00 representing sales taxes, penalties and interest paid by Itel to the Department of Revenue ("Department") under protest on April 7, 1988. 2. The alleged sales tax deficiency was assessed upon the proceeds received by Itel from leases of its cargo containers which were used exclusively in international commerce. 3. Each of the leases was negotiated, delivered and executed outside the state of Tennessee and each of the cargo containers was delivered within the state of Tennessee to each respective lessee's trucker or a shipper for future leasing.

4. Itel is a delaware corporation, with its principal corporate office in San Francisco, California. 5. Itel's

principal business is the leasing of cargo containers for international use. 6. The particular containers whose lease proceeds were assessed by the Department for the audit period beginning January 1, 1983 through November 30, 1986 (the "Audit Period") are referred to as "Container(s)." 7. Itel's commercial domicile and principal place of business is San Francisco, California.

8. Containers are specially manufactured steel boxes, 20 or 40 feet long, 8 feet wide and 8.5 or 9.5 feet tall. 9. The containers are uniquely designed so that they may be used to transport goods by a variety of modes, including semi-trailer truck, rail car or oceangoing vessel. 10. The containers are secured to rolling stock while transported overland in international commerce. 11. Because these containers are designed to be used in a variety of transportation modes, they are uniquely suited for use in international commerce.

12. The United States is a signatory and contracting party to the Customs Convention on Containers, effective 1956 and the Customs Convention on Containers, effective 1972. 13. Attached as plaintiff's exhibits 11 and 12 are true, accurate, complete, authentic and admissible copies of the Customs Conventions on Containers, effective 1956 and 1972, one or both of which, were signed by countries in which companies leasing eighty-four percent (84%) of the containers were domiciled.

14. The United States Congress has provided in 19 U.S.C. § 1322(a) that "[v]ehicles and other instruments of international traffic, of any class specified by the Secretary of the Treasury, shall be excepted from the application of the customs laws to such extent and subject to such terms and conditions as may be prescribed in regulations or instructions of the Secretary of the Treasury." 15. The Secretary of the Treasury, through the United States Customs Service, has promulgated regulations which in accordance with the Convention, identify containers as instruments of international traffic:

> (a)(1) . . . [C]argo vans . . . in use or to be used in the shipment of merchandise in international traffic are hereby designated as "instruments of international traffic" within the meaning of Section 322(a) Tariff Act of 1930, as amended. . . . Such instruments may be released without entry or the payment of duty, subject to the provisions of this section.

19 C.F.R. § 10.41(a)(1). 16. Subparagraph (3) provides that "instruments of international traffic" includes the normal accessories and equipment imported with any such instrument which is a "container," as defined in Article 1 of the Customs Convention on Containers. 17. Article 1 of the Customs Convention on Containers defines "container" as follows:

> An article of transport equipment (life-van, movable tank or other similar structure):
>
> (i) Fully or partially enclosed to constitute a compartment intended for containing goods;
>
> (ii) Of a permanent character and accordingly strong enough to be suitable for repeated use;
>
> (iii) Specially designed to facilitate the carriage of goods, by one or more modes of transport, without intermediate reloading;
>
> (iv) Fitted with devices permitting its ready handling, particularly its transfer from one mode of transport to another;
>
> (v) So designated to be easy to fill and to empty; and
>
> (vi) Having an internal volume of one cubic metre or more and shall include the normal accessories and equipment of the container, when imported with the container; the term "container" includes neither vehicles nor conventional packing.

18. As long as the Containers are "in use or to be used in the shipment of merchandise in international traffic," they are instruments of international traffic and are not subject to the payment of import and export duties and taxes. 19. If a Container is withdrawn from its exclusive use in international commerce without the prior approval and release of the United States Government and payment of all duties and taxes, the applicant is liable for the payment of liquidated damages. 19 C.F.R. § 10.41(a)(g).

20. The Containers were all manufactured and purchased abroad by Itel and entered the United States and approved and identified by design type as instruments of international traffic. 21. Itel has posted a continuous bond with the United States Customs Service, a true, accurate, authentic and admissible copy of which is attached as plaintiff's exhibit 16, which covers all duties, taxes or liquidated damages which could be assessed for a failure to comply with government regulations regarding Itel's withdrawal of any of containers from international commerce.

22. Itel solicits container leases worldwide through its marketing offices located in San Francisco and Los Angeles, California; Houston, Texas; Chicago, Illinois; Teaneck, New Jersey; Charleston, South Carolina and Seattle, Washington. 23. No Itel leasing or marketing employees are or were located in Tennessee. 24. Itel accepts leases of its containers only in its San Francisco office. 25. As a result of its international operations, Itel allows customers to interchange containers at numerous locations around the world and in the United States. 26. Itel principally leases its containers to international shipping companies. 27. Itel leases the containers on a per diem basis. 28. While the lessee determines the containers' route of travel and to a limited extent the length of use, all container leases restrict the use of Containers

to international commerce. 29. With certain restrictions, the lessee determines where the container shall be redelivered at the close of the lease term. 30. For this reason, the inventory of containers at a particular terminal location may fluctuate widely, depending on the convenience and needs of lessees.

31. Prior to July 1, 1985, Itel did not have any employees or terminals located in Tennessee. 32. Before that time, Itel allowed its containers to be delivered and picked up at two-three "neutral" or "third party" depots located in Tennessee. 33. Effective August 1, 1985, Itel leased a tract of land and buildings located at 3126 Carrier Street, Memphis, Tennessee. 34. A terminal building and workstation were used to receive, store, deliver and in certain circumstances, repair Containers. 35. From July 1, 1985 to the close of the audit period, Itel employed four persons at the Memphis terminal. 36. These employees were responsible for the receiving, temporary storage, delivery, and in certain circumstances, repair of the Containers. 37. After July 1, 1985, Itel continued to allow customers to interchange containers at two-three neutral depots located in Tennessee. 38. Itel is registered as a dealer with the Department and collcts and remits sales and use tax to the Department on fees which it collects for repair services rendered, and some of the Containers were repaired while temporarily located in Tennessee during the audit period.

39. Itel had no employees at the three neutral or third party pool locations in Tennessee during the audit period. 40. Itel has never had any marketing office located in Tennessee. 41. There is not and has never been any Itel employee located in Tennessee for the purpose of soliciting or receiving offers for the leasing of Containers. 42. No Itel employees or representatives execute leases in Tennessee. 43. None of Itel's lessees during the audit period were Tennessee corporations, entities or individ-

uals. 44. None of the Containers were leased for use in intrastate Tennessee commerce.

45. There are three kinds of Itel lease transactions upon which the Department has collected a tax: (1) Master Interchange ("MI") leases; (2) short term leases; and (3) shipper pool arrangements. 46. Most of the Containers leased by Itel are leased under MI agreements.

47. The chief difference between MI leases and short term leases is that in the former, Itel and a prospective lessee agree to certain terms which will apply to future leases and in the latter, all of the commercial terms are determined on a case by case basis. 48. In most other respects, both kinds of leases are executed in a similar fashion. 49. Under the MI agreement, Itel and a prospective lessee agreed to certain terms which apply prospectively to future leases of Containers. 50. These terms include the price, approved locations for pickup and redelivery, minimum lease periods and the general contract terms and conditions which shall apply to all future leases. 51. Under the MI agreement, Itel "agrees to lease Containers to Lessee on an as available basis at any Itel depot in Europe and United States or any United States neutral pool location."

52. Itel receives lease commitments from prospective lessees by telephone. 53. None of the Container lessees had offices located in Tennessee and thus, none of the telephone calls were initiated from Tennessee. 54. The prospective lessee telephoned one of Itel's Intermodal Services Group, located in San Francisco, California.

56. Accordingly, a prospective lessee initially contacted either a regional marketing office or the Intermodal Services Group. 57. After determining that the container to be leased is located in a Tennessee terminal or pool, the prospective lessee would be referred to Intermodal Services for the lease commitment. 58. The Intermodal Services Group would call up a lease commitment form on the computer screen. 59. If the lessee was subject to a MI agreement, the price, redelivery locations and other terms were fixed. 60. The prospective lessee would provide the desired pickup date, equipment type and quantity. 61. In the case of a short term lease, all commercial terms would be addressed by telephone with the Intermodal Services Group. 62. Itel's marketing representative would conditionally agree to the release of the type and quantity of containers, the pickup date and provide a release number. 63. The release number would be communicated by telephone, telex or intercompany computer to Itel's delivery location. 64. At the close of the telephone conversation between the lessee and Itel's marketing representative, the lessee would be obligated to lease a particular type and quantity of container beginning from the designated pickup date under the terms and conditions set forth in the master interchange agreement or the short term lease. 65. Based upon that binding commitment, Itel would then reserve the type and quantity of containers leased at the selected location.

66. Itel provided the leased containers to the lessee's carrier or trucker on the pickup date and an Itel representative and the lessee's truck driver signed a one-page document entitled "Equipment Condition Report" ("ECR"), which acknowledged delivery of the container on the pickup date in good condition.

67. After the pickup of the Container by the carrier, Itel issued a typed lease agreement from its San Francisco offices reflecting the terms and conditions of the lease, container identification numbers, date of the lease, replacement value of the container, permitted redelivery locations, lease number, terminal of origination, date of master interchange agreement (if applicable), date of lease preparation and any additional terms and conditions.

68. Shipper pool arrangements differ from MI agreement leases and short term leases in that the shipper picked up the container prior to the acceptance of any lease commitment by a steamship company lessee. 69. A shipper signed an equipment condition report acknowledging that the container was in good condition. 70. After the container was picked up, the shipper loaded the container and transported it to an international port for transportation in international commerce. 71. Upon delivery of the loaded container to an approved ocean going steamship line, a binding lease commitment, either an MI or short lease, was made by the steamship line subject to Itel's acceptance at its San Francisco offices.

72. All Itel leases have the following provision printed in large type on the front page of the lease:

> CONTAINER(S) LEASED HEREINABOVE SHALL BE USED SOLELY IN INTERNATIONAL TRADE UNLESS IT IS SPECIFICALLY STATED BELOW TO THE CONTRARY.

73. All leases of the Containers include the above provision and none of the Container leases included terms which allow use contrary to the international trade stipulation. 74. Paragraph 7(b) of each master interchange agreement provided that "a standard Itel Lease shall be issued to and signed by Lessee for each and every container leased."

75. The standard lease agreement provided in paragraph 11(f) as follows:

> In the event Lessee has not executed Master or Long Term Agreement with Lessor covering the leasing of this equipment, this Lease shall contain the entire agreement between the parties with respect to the subject matter hereof and may be amended, modified, or changed only by an agreement in writing executed by the parties hereto. If Lessee fails, however, to give to Lessor a written objection to its

> contents within seven (7) days after this Lease is received, or if Lessee takes possession of any of the equipment provided for hereunder and retains it after receipt of this Lease then this Lease shall be effective and binding upon Lessee whether or not signed. *Notwithstanding any Master or Long Term Agreement, this Lease is subject to acceptance by Lessor at its office in San Francisco, California, and shall be deemed accepted if Lessee is not notified to the contrary within reasonable time.* If the Lease is not accepted, Lessee shall return the equipment to any of Lessor's terminals within sixty (60) days from such notification.

76. None of the Containers were dedicated to any local use during their stay in the state. 77. Itel and all Container lessees have agreed and intended that the Containers be used solely in international trade.

78. The Containers are not goods which are consumed by any lessee. 79. While the goods which may be carried in the Containers had a final destination which led to an end use in local or intrastate commerce, none of the Containers has been used in local or intrastate commerce. 80. While the Containers were temporarily in Tennessee, some of the Containers were temporarily not subject to a lease agreement. 81. Itel earns no revenue from the use of the Containers while present at its Memphis, Tennessee terminal or any of the two-three neutral depot locations located in Tennessee. 82. The interruption of movement in Tennessee was not for the purpose of any use of the Containers prior to the continuation of international movement.

83. Itel was audited by the state of Tennessee Department of Revenue, Sales and Use Tax Division, for the period of January, 1983 through November, 1986. 84. On December 31, 1986, Itel received an assessment letter from the Department, stating that additional Tennessee

sales and/or use tax was due for the above period. 85. The Department computed the tax based upon the calculation of the "average container days leased" and "average containers leased per month." 86. To calculate the "average container days leased," the total number of days that all containers leased during the test period were on lease was divided by the total number of containers leased during the test period. 87. The Department determined the "average containers leased per month" by dividing the total number of containers leased during the test period by the total number of months of the test period, or two months. 88. The Department's tax, interest and penalty assessment was based on 194.27 "average container days leased" and 65.5 "average containers leased per month" for the test period. 89. Itel paid the assessment of additional tax, penalties and interest on April 7, 1988 under protest. 90. On June 27, 1988, Itel filed a request for refund with respect to the assessment in accordance with T.C.A. § 67-1-1801. 91. The request for refund was denied on June 29, 1988. 92. Each of plaintiff's trial exhibits identified as exhibits 1-21 in the plaintiff's pretrial compliance is authentic and admissible in evidence at the trial of this action, except that the defendant does not stipulate that Exhibits 13 and 15 include documentation of all of the taxable transactions during the audit test period.

HAVE SEEN AND AGREED:

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APPENDIX D

The Commerce Clause of the United States Constitution, Art. I, § 8, Cl. 3, provides in relevant part:

> Congress shall have the Power * * * To regulate commerce with foreign Nations, and among the several States.

The Import-Export Clause of the United States Constitution, Art. I, § 10, Cl. 2, provides:

> No State shall, without the Consent of Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its inspection Laws.

The Supremacy Clause of the United States Constitution, Art. VI, Cl. 2, provides:

> This Constitution, and the Laws of the United States which shall be made in pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

The 1972 Customs Convention on Containers, December 2, 1972, [1985] 988 U.N.T.S. 43, provides in relevant part:

PREAMBLE

The Contracting Parties,
Desiring to develop and facilitate
international carriage by container,
Have agreed as follows:

Chapter I. General

Article I. For the purposes of the present Convention:

(*a*) The term "import duties and taxes" shall mean Customs duties and all other duties, taxes, fees and other charges which are collected on, or in connexion with, the importation of goods, but not including fees and charges limited in amount to the approximate cost of services rendered;

(*b*) The term "temporary admission" shall mean temporary importation, subject to re-exportation, free of import duties and taxes and free of import prohibitions and restrictions;

(*c*) The term "container" shall mean an article of transport equipment (lift-van, movable tank or other similar structure):

(i) fully or partially enclosed to constitute a compartment intended for containing goods;

(ii) of a permanent character and accordingly strong enough to be suitable for repeated use;

(iii) specially designed to facilitate the carriage of goods, by one or more modes of transport, without intermediate reloading;

(iv) designed for ready handling, particularly when being transferred from one mode of transport to another;

(v) designed to be easy to fill and to empty; and

(vi) having an internal volume of one cubic metre or more;

the term "container" shall include the accessories and equipment of the container, appropriate for the type concerned, provided that such accessor-

ies and equipment are carried with the container. The term "container" shall not include vehicles, accessories or spare parts of vehicles, or packaging;

(*d*) The term "internal traffic" shall mean the carriage of goods loaded in the territory of a State for unloading at a place within the territory of the same State;

(*e*) The term "person" shall mean both natural and legal persons;

(*f*) The term "operator" of a container shall mean the person who, whether or not its owner, has effective control of its use.

Article 2. In order to benefit from the facilities provided for in the present Convention, containers shall be marked in the manner prescribed in annex 1.

Chapter II. Temporary Admission

(a) *Temporary admission facilities*

Article 3. 1. Subject to the conditions laid down in articles 4 to 9, each Contracting Party shall grant temporary admission to containers, whether loaded with goods or not.

2. Each Contracting Party reserves the right not to grant temporary admission to containers which have been the subject of purchase, hire-purchase, lease or a contract of a similar nature, concluded by a person resident or established in its territory.

Article 4. 1. Containers granted temporary admission shall be re-exported within three months from the date of importation. However, this period may be extended by the competent Customs authorities.

2. Containers granted temporary admission may be re-exported through any competent Customs office, even if that office is different from the one of temporary admission.

The 1956 Customs Convention on Containers, May 18, 1956, [1969] 20 U.S.T. 301, provides in relevant part:

PREAMBLE

The Contracting Parties,

Desiring to develop and to facilitate the use of containers in international traffic,

Have agreed as follows:

CHAPTER I

DEFINITIONS

Article 1

For the purposes of this Convention:

(*a*) The term "important duties and import taxes" shall mean not only Customs duties but also all duties and taxes whatsoever chargeable by reason of importation;

(*b*) The term "container" shall mean an article of transport equipment (lift-van, movable tank or other similar structure):

(i) Of a permanent character and accordingly strong enough to be suitable for repeated use;

(ii) Specially designed to facilitate the carriage of goods by one or more modes of transport, without intermediate reloading;

(iii) Fitted with devices permitting its ready handling, particularly its transfer from one mode of transport to another;

(iv) So designed as to be easy to fill and empty; and

(v) Having an internal volume of one cubic metre or more;

and shall include the normal accessories and equipment of the container, when imported with the container; the term "container" includes neither vehicles nor conventional packing;

(c) The term "persons" shall mean both natural and legal persons unless the context otherwise requires.

CHAPTER II

TEMPORARY IMPORTATION FREE OF IMPORT DUTIES AND IMPORT TAXES AND FREE OF IMPORT PROHIBITIONS AND RESTRICTIONS

Article 2

Each of the Contracting Parties shall grant temporary admission free of import duties and import taxes and free of import prohibitions and restrictions, subject to re-exportation and to the other conditions laid down in articles 3 to 6 below, to containers when they are imported loaded to be re-exported either empty or loaded, or imported empty to be re-exported loaded. Each Contracting Party shall retain the right to withhold these facilities in the case of containers which are imported on purchase or otherwise taken into effective possession and control by a person resident or established in its territory; the same applies to containers imported from a country which does not apply the provisions of this Convention.

Article 3

Containers temporarily imported free of import duties and import taxes shall be re-exported within three months from the date of importation. This

period may be extended for valid reasons by the Customs authorities within the limits laid down by the legislation in force in the territory into which containers have been temporarily imported.

19 U.S.C. 1322(a) provides:

Vehicles and other instruments of international traffic, or any class specified by the Secretary of the Treasury, shall be excepted from the application of the customs laws to such extent and subject to such terms and conditions as may be prescribed in regulations or instructions of the Secretary of the Treasury. The authority delegated to the Secretary by this subsection shall not extend to communications satellites and components and parts thereof.

19 C.F.R. 10.41a provides in relevant part:

(a)(1) Lift vans, cargo vans, shipping tanks, skids, pallets, caul boards, and cores for textile fabrics, arriving (whether loaded or empty) in use or to be used in the shipment of merchandise in international traffic are hereby designated as "instruments of international traffic" within the meaning of Section 322(a), Tariff Act of 1930, as amended. The Commissioner of Customs is authorized to designate as instruments of international traffic, in decisions to be published in the weekly Customs Bulletin, such additional articles or classes of articles as he shall find should be so designated. Such instruments may be released without entry or the payment of duty, subject to the provisions of this section.

* * * *

(a)(3) As used in this section, "instrumentalities of international traffic" includes the normal accessories and equipment imported with any such instrument which is a "container" as defined in Article 1 of the Customs Convention on Containers.

* * * *

(g) For failure promptly to report the diversion or withdrawal or promptly to make the required entry and pay the duties due, the applicant shall be liable for the payment of liquidated damages equal to the domestic value of the instrument established in accordance with Section 606, Tariff Act of 1930.

19 C.F.R. 115.1 provides:

This chapter establishes procedures for certifying containers and road vehicles in conformance with the Customs Convention on Containers (1956) (TIAS-6634), the Customs Convention on the International Transport of Goods Under Cover of TIR Carnets (1959) (TIAS 6633), the Customs Convention on the International Transport of Goods Under Cover of TIR Carnets, November 14, 1975 (TIAS), and the Customs Convention on Containers, 1972 (TIAS), by applying the procedures and technical conditions set forth in the annexes to these conventions.

Tenn. Code Ann. 67-6-102(23)(A) (1989) provides in relevant part:

"Sale" means any transfer of title or possession, or both, exchange, barter, lease or rental, conditional, or otherwise, in any manner or by any means whatsoever of tangible personal property for a consideration * * *.

(2)

No. 91-321

Supreme Court, U.S.
FILED
SEP 20 1991
OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1991

ITEL CONTAINERS INTERNATIONAL CORPORATION,

Petitioner,

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE, STATE OF TENNESSEE,

Respondent.

Petition For A Writ Of Certiorari To The Supreme Court Of Tennessee

BRIEF IN OPPOSITION TO THE PETITION

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QUESTIONS PRESENTED

1. Whether a state sales tax levied on the privilege of engaging in business in the taxing state, which is measured by the gross proceeds derived by a lessor from lease contracts in which the leased property is located in and delivered to the lessee in the taxing state, is precluded by the Foreign Commerce Clause from being imposed on such leases of cargo containers which are ultimately used in international commerce.

2. Whether such a state tax is preempted by the Customs Conventions on Containers.

3. Whether such a state tax is precluded by the Import-Export Clause.

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No. 91-321

In The

Supreme Court of the United States

October Term, 1991

ITEL CONTAINERS INTERNATIONAL CORPORATION,

Petitioner,

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE, STATE OF TENNESSEE,

Respondent.

Petition For A Writ Of Certiorari To The Supreme Court Of Tennessee

BRIEF IN OPPOSITION TO THE PETITION

STATEMENT OF THE CASE

The Tennessee Department of Revenue assessed sales tax against Itel Containers International Corporation as a result of Itel's substantial business activities transacted wholly within Tennessee. Itel is a Delaware corporation, based in California, which operates business facilities and locates substantial amounts of its property in Tennessee. Itel is primarily engaged in the business of furnishing, as lessor, cargo containers to its customers for their use in transporting goods in international commerce.

The Department assessed tax for business activities which occurred in Tennessee during the audit period of January 1, 1983, through November 30, 1986. Tax was assessed upon the gross proceeds derived by Itel from its lease contracts in which containers stored in Tennessee were delivered in Tennessee to Itel's lessees or their agents.

During the audit period, containers belonging to Itel were placed at depots at such Tennessee locations as Memphis, Nashville, and Chattanooga. Also, during the latter part of the audit period, Itel maintained a terminal of its own at Memphis. The terminal, staffed by a number of Itel employees, was used by Itel to receive incoming containers being returned at the conclusion of their leases, to store containers, and to perform repair work, and as the site at which containers going out on lease were delivered to and picked up by Itel's customers.

Itel's containers, while under lease, were used exclusively in international commerce. However, Itel was not itself an importer, exporter, or shipper of the goods transported in such containers. Each container was brought into Tennessee at the conclusion of one lease and stored there until it was delivered to another customer at the beginning of another lease. Thus, the container's presence in Tennessee was not a part of a continuous lease term or of a continuous journey carrying goods.

Originally, the sales tax assessment in this case also included Itel's proceeds from leases in which containers stored in Tennessee were delivered at out-of-state locations. The trial court disallowed that portion of the

assessment, holding that where delivery was consummated outside Tennessee the transactions were not properly taxable by Tennessee. (App. at 20a-21a). The Department of Revenue did not appeal that holding, but accepted it as a proper decision under the facts and law.

Both the trial court and the Tennessee Supreme Court upheld the portion of the assessment attributable to Itel's leases in which delivery to the lessees occurred within Tennessee. Itel now seeks further review of that Tennessee Supreme Court decision.

REASONS FOR DENYING THE WRIT

The decision of the Tennessee Supreme Court does not conflict with the decisions of this Court, federal courts of appeals, or other state courts of last resort. This case was correctly decided, based upon Tennessee law interpreting the nature and scope of the sales tax statutes, and upon analytical guidelines announced by this Court in prior cases. Because the tax in this case was upon the proceeds of business activities conducted by an American corporation entirely within the taxing state, this case has very little significance to the development of foreign policy issues or Import-Export or Commerce Clause jurisprudence. For all of these reasons, further review is unwarranted.

I. THE TENNESSEE COURT PROPERLY ANALYZED THE NATURE OF THE TAX AND THE TRANSACTIONS IN THIS CASE, CONSISTENT WITH THIS COURT'S DECISIONS.

Itel misapprehends, and thus mischaracterizes, the nature of the tax in this case. The sales tax here was imposed on Itel's business activities; it was not a property tax on the containers, such as the tax stricken in *Japan Line Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979). Tenn. Code Ann. § 67-6-201 provides:

> It is declared to be the legislative intent that every person is exercising a taxable privilege who engages in the business of selling tangible personal property at retail in this state . . . or who rents or furnishes any of the things or services taxable under this chapter . . . or who leases or rents such property, either as lessor or lessee, within the State of Tennessee. . . .

The sales tax is not an *ad valorem* property tax, but instead a privilege tax on persons engaging in certain types of business activities in Tennessee. *Hooten v. Carson*, 186 Tenn. 282, 285, 209 S.W.2d 273 (1948). Property taxes are direct taxes on the value of the property, and therefore require some appraisal and assessment of the actual value. The Tennessee sales tax, on the other hand, is measured not by the value of the property, but by the total consideration, or the "gross proceeds," received under a contract of sale or lease. Itel erroneously asserts that the rentals received under a lease are simply that portion of the value of the leased property corresponding to the time limits of the lease. Realistically, however, the consideration in a lease contract is simply a figure agreed upon by the parties to reflect numerous factors. Often the consideration in a lease contract bears scant relationship to the actual value of the leased property.

Tennessee's sales tax on leasing activity is measured by the "gross proceeds" of the lease, which includes everything of value received by the lessor under the lease, and is not determined necessarily by the value of the leased property. *Furniture Lease Co. v. Tidwell*, 495 S.W.2d 535, 536 (Tenn. 1973). The taxable gross proceeds of a lease include charges, often hidden or "built-in," for services rendered by the lessor. *Saverio v. Carson*, 186 Tenn. 166, 168, 208 S.W.2d 1018 (1948). Therefore, Tennessee's sales tax on leases is not a direct tax on property, and is not measured by the value of property. Instead, Tennessee's tax measured by the gross proceeds of leases is more akin to a tax on income derived from leases. Such a tax is patently distinguishable from the flat, direct property tax in *Japan Line*.[1]

Itel also incorrectly characterizes the Tennessee tax as a "transit fee on the privilege of moving through a State."

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[1] In *Japan Line*, this Court took note of the Convention Between the United States of America and Japan for the Avoidance of Double Taxation, Mar. 8, 1971 [1972], 23 U.S.T. 967, 1084-1085, T.I.A.S. No. 7365, which provided that income "derived by a resident of a Contracting State . . . from the use, maintenance, and lease of containers and related equipment . . . in connection with the operation in international traffic of ships or aircraft . . . is exempt from tax in the other Contracting State." *Japan Line*, 441 U.S. at 446, n.10. Thus, as that international agreement, and this Court, recognized, a tax on proceeds derived from the lease of containers is plainly different from a direct property tax on the containers themselves.

However, the tax here is a generally applicable tax on all business activity in Tennessee involving the transfer of possession of tangible personal property for consideration, and is not aimed selectively at items merely passing through the state. To the contrary, Tenn. Code Ann. § 67-6-313(a) expressly provides:

> It is not the intention of this chapter to levy a tax upon articles of tangible personal property imported into this state or produced or manufactured in this state for export.

This "import-for-export" exemption clearly provides that if, for example, Itel imported its containers into Tennessee and then itself exported the containers, without transferring them to lessees while in Tennessee, the sales tax would not be imposed. *Beecham Laboratories v. Woods*, 569 S.W.2d 456, 458 (Tenn. 1978). It is only when some intervening transfer of title or possession occurs in Tennessee – in other words, when specific business activity occurs in Tennessee – that the tax is imposed. *Jack Daniel Distillery v. Jackson*, 740 S.W.2d 413, 416 (Tenn. 1987). Thus, the sales tax in this case does not necessarily reach all of Itel's containers moving through Tennessee. Tax is imposed only when Itel engages in specific and substantial business activity – transfer of possession to a lessee for consideration – in Tennessee. The trial court recognized this when it disallowed tax on transactions in which Itel delivered containers from its various Tennessee locations, but where the transfer of possession to the lessee for consideration occurred outside Tennessee. (Chancery Court Memo., App. at 20a-21a). It should be noted that this portion of the trial court's ruling, favorable to Itel, was not appealed by the Commissioner of Revenue.

Similarly, Itel is incorrect in characterizing the Tennessee sales tax as a tax "chargeable by reason of importation," or "collected on, or in connexion with, the importation of goods," as those terms are used in the Customs Conventions on Containers. *See* 1956 Customs Convention on Containers, May 18, 1956 [1969], 20 U.S.T. 301, Art. 1(a) (App. at 41a); 1972 Customs Convention on Containers, Dec. 2, 1972 [1985], 988 U.N.T.S. 43, Art. 1(a) (App. at 39a). The Tennessee tax simply is not levied on imports, but is a generally applicable sales tax. Further, many imports, including many of Itel's imported containers, are never involved in taxable transactions in light of the "import-for export" exemption expressly provided by Tenn. Code Ann. § 67-6-313(a). The Customs Conventions on Containers, so broadly relied upon by Itel, do not even address, much less forbid, Tennessee's sales tax.

The fact that Itel's transfers of containers in Tennessee are taxable, while containers from Tennessee which are transferred out-of-state are not taxable, further illustrates that the tax here is not upon the containers themselves, but rather upon the business activity engaged in by Itel in Tennessee. Further still, the incidence of the sales tax in this case was not upon the containers, or the lessees of the containers, but upon Itel as lessor. *Beare Co. v. Olsen*, 711 S.W.2d 603, 605 (Tenn. 1986). Although Tennessee statutes provide for Itel to pass the tax on to its customers, if possible, the legal burden of and ultimate liability for the tax are only upon Itel. *Id.; Smoky Mountain Canteen Co. v. Kizer*, 193 Tenn. 598, 603, 247 S.W.2d 69 (1952). The tax is not upon the value of certain property, but upon the business activities in Tennessee of a company which chooses to locate its business in Tennessee

and enjoy the benefits and protections furnished by the State.

Therefore, the Tennessee Supreme Court correctly held that the tax in this case is not a direct tax on the containers, such as the property tax in *Japan Line* (App. at 12a), but is a tax on Itel's business activities, discrete transactions occurring only within Tennessee. (App. at 14a).

II. THE TENNESSEE SUPREME COURT'S DECISION IN THIS CASE DOES NOT CONFLICT WITH APPLICABLE DECISIONS OF THIS COURT OR OF OTHER COURTS.

Because the Tennessee Supreme Court correctly understood the true nature of the Tennessee sales tax, it correctly held that the tax withstood Itel's constitutional challenges.

The Tennessee court correctly found that the tax in this case is different from the direct *ad valorem* property tax in *Japan Line*, and that the *Japan Line* opinion does not even purport to reach the facts of this case. (App. at 7a-8a). *Japan Line*, 441 U.S. at 444, n.7. Instead, the sales tax on Itel's business activities in Tennessee is more analogous to the taxes upheld against similar constitutional challenges in *Wardair Canada, Inc. v. Florida Dept. of Revenue*, 471 U.S. 1 (1986) (sales tax on fuel used in international aviation), and *Dept. of Revenue v. Ass'n of Washington Stevedoring Companies*, 435 U.S. 734 (1978) (business and occupation tax on stevedoring activities). (App. at 12a). Nonetheless, the Tennessee court followed the guidelines set forth in the *Japan Line* decision for

analysis of the foreign commerce element of the Commerce Clause, U.S. Const. Art. I, §8, cl. 3. (App. 12a). Therefore, the decision in this case does not conflict with the *Japan Line* decision, but instead follows the analytical path laid out by *Japan Line*, *Wardair*, and *Washington Stevedoring*.

Similarly, the Tennessee court's rejection of Itel's challenges under the Import-Export Clause, U.S. Const. Art. I, §10, cl. 3, does not conflict with the recent decision in *Louisiana Land and Exploration Co. v. Pilot Petroleum Corp.*, 900 F.2d 816 (5th Cir. 1990), *cert. denied*, ___ U.S. ___ , 111 S.Ct. 248 (1991), relied upon by Itel. In *Louisiana Land*, the challenged Alabama tax was levied specifically on fuel, and was not a generally applicable sales tax such as the Tennessee tax in this case. 900 F.2d at 817, n.1. Because the Alabama tax was aimed at a specific category of goods, it was susceptible to being used to create a special tariff, in violation of the Import-Export Clause. *See Washington Stevedoring*, 435 U.S. at 753. Further, the incidence of the Alabama tax was on the consumer, unlike the Tennessee tax which is levied upon the seller. 900 F.2d at 818. Therefore, the Alabama tax was not a tax on the seller's business activities, but arguably constituted a direct tax on property purchased by the consumer. For those reasons, the tax in *Louisiana Land* is distinguishable from the tax in this case. Regardless of whether goods are "in transit," the Import-Export Clause analysis of direct taxes employed in *Louisiana Land* does not apply when, such as in the present case, the challenged tax is not a direct tax. *Washington Stevedoring*, 435 U.S. at 757. Instead, the Tennessee Supreme Court correctly applied the modern three-prong policy analysis of *Michelin Tire*

Corp. v. Wages, 423 U.S. 276, 285-6 (1976), in upholding the tax against Itel's Import-Export Clause challenge. (App. at 17a).

In summary, the decision in this case does not conflict with any decision of this Court, of a court of last resort of any other state, or of any federal court of appeals. The Tennessee Supreme Court correctly decided this case, and further review is unwarranted.

CONCLUSION

For the reasons set forth above, the Commissioner of Revenue of the State of Tennessee respectfully submits that the decision of the Tennessee Supreme Court in this case is correct, and that further review of this case is unwarranted. Therefore, the petition for writ of certiorari should be denied.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1991

ITEL CONTAINERS INTERNATIONAL CORP., PETITIONER

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE, STATE OF TENNESSEE, RESPONDENT

On Petition for a Writ of Certiorari to the Supreme Court of Tennessee

PETITIONER'S REPLY BRIEF

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In the Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-321

ITEL CONTAINERS INTERNATIONAL CORP., PETITIONER

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE,
STATE OF TENNESSEE, RESPONDENT

On Petition for a Writ of Certiorari to the Supreme Court of Tennessee

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PETITIONER'S REPLY BRIEF

In its response, the State does not take issue with *any* of the fundamental propositions that are advanced in the petition. It does not deny that the question whether transaction taxes are inherently immune from challenge under the Foreign Commerce Clause is a recurring and extremely important one that was left open in *Wardair Canada, Inc. v. Dept. of Revenue*, 477 U.S. 1, 13 (1986). It does not deny that its tax poses the risk of multiple taxation, imposes significant burdens on the operation of containers in international commerce, may prompt retaliation by our trading partners, and will raise the costs of imports to and exports from the United States. It does not deny that this Court's decisions in *Xerox Corp. v. Harris County*, 459 U.S. 145 (1982), and

McGoldrick v. Gulf Oil Corp., 309 U.S. 414 (1940), held state taxes preempted in circumstances that are indistinguishable from those in this case. And it does not deny that Itel's containers are imports and exports within the meaning of the Import-Export Clause that were "in transit" at the time of taxation. The State accordingly advances no reason for the Court to decline review of the substantial issues presented here.

1. The State's principal argument sidesteps the point of the petition. The State maintains (Br. in Op. 4-5, 6, 7) that its tax is not measured by the value of the property that is sold or leased, and that the levy accordingly cannot be analogized to a property tax. But even if that statement is correct—and it demonstrably is not, as we explain below—it simply is not responsive to the petition. Our Foreign Commerce Clause argument is not grounded on the proposition that Tennessee's levy *is* a property tax; to the contrary, the first question presented is whether, under *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), there is a necessary constitutional distinction *between* sales and property taxes, as the court below held. See Pet. 10-16.

We think it plain that transaction taxes should not be immune from challenge under the Clause. As we explained in the petition, the Court's reasons for invalidating the property tax at issue in *Japan Line*—concerns about multiple international taxation and interference with federal policy—have nothing to do with the distinction between property and sales taxes. See *Wardair*, 477 U.S. at 18 (Blackmun, J., dissenting). Cf. *Xerox*, 459 U.S. at 153 (for preemption purposes, no "legal difference" between sales and

property taxes); *R.J. Reynolds Tobacco Co. v. Durham County*, 479 U.S. 130, 142-143 n.10 (1986) (distinction "of no importance"). The State's conclusory assertion (Br. in Op. 8-9) that the court below "followed the guidelines" announced in *Japan Line* misses the mark; the state court set down a legal rule governing challenges to transaction taxes that is inconsistent with the *Japan Line* analysis. And most fundamentally for present purposes, the State has not offered any reason to doubt that the issue is a significant and recurring one that warrants this Court's attention.

In any event, the State's claim (see Br. in Op. 4-5) that sales and lease taxes are largely unrelated to the value of the underlying property is a nonsensical one that has been flatly rejected by the Court. "[T]he Court ha[s] always considered a tax on the sale of goods to be a tax on the goods themselves. * * * The sale ha[s] no value or significance apart from the goods." *Department of Revenue v. Ass'n of Washington Stevedoring Cos.*, 435 U.S. 734, 756 n.21 (1978).[1] And labeling the tax one on "privilege" or "business activity" (see Br. in Op. 4) "does not permit [the Court] to forgo examination of the actual tax base * * *. 'A tax on sleeping measured by the number of pairs of shoes you have in your closet is a tax on shoes.'" *Trinova Corp. v. Michigan Department of Treasury*, 111 S. Ct. 818, 829 (1991) (citation omitted). Accord *Richfield Oil Corp. v. State Board of Equalization*, 329 U.S. 69, 84 (1946).

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[1] If the State means to distinguish taxes on sales from taxes on leases, its contention is belied by one of Tennessee's own methods of valuing personal property for property tax purposes—capitalization of rental income over the life of the property. Tenn. Code Ann. 67-5-602(c)(1).

The State makes no attempt to distinguish these authorities.

2. The State also contends that the Container Conventions are inapplicable here because "[t]he Tennessee tax simply is not levied on imports, but is a generally applicable sales tax." Br. in Op. 7. The assertion that such a distinction is relevant, however, is irreconcilable with this Court's decisions. *Japan Line*, of course, invalidated a generally applicable state tax as inconsistent with the 1956 Convention. See 441 U.S. at 452-453. And as we explain in the petition (at 20-23), the Court in *McGoldrick* and *Xerox* struck down generally applicable state sales and property taxes because they frustrated the federal policies effectuated by the Customs-bonded warehouse statutes—policies that are directly analogous to those advanced by the Container Conventions. Again, the State wholly fails to address these rulings. By the same token, the State does not (and plainly could not) deny either that its tax burdens the use of containers or that our trading partners refrain from imposing equivalent taxes on the lease of containers abroad.[2]

3. Finally, the State's assertion that the decision below does not conflict with *Louisiana Land and Exploration Co. v. Pilot Petroleum Corp.*, 900 F.2d 816 (5th Cir.), cert. denied, 111 S. Ct. 248 (1990), rests on distinctions that are immaterial—and that already have been dismissed as irrelevant by this Court. First, the State notes that the tax at issue in *Louisiana Land* was levied specifically on sales of fuel rather than on all sales. But the Court never has held that a tax must be directed at a specific good to constitute an impost upon imports or exports within the meaning of the Import-Export Clause. To the contrary, in *Richfield Oil Corp. v. State Board of Equalization*, 329 U.S. 69, 83 (1946), the Court invalidated a state sales tax directed at all transfers of "tangible personal property at retail." The crucial question thus is whether the levy, *as applied*, constitutes a tax on imports or exports that are in transit when the tax is assessed. See *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 290 (1976).

Second, the State observes that the incidence of the Alabama tax at issue in *Louisiana Land* fell on the purchaser and suggests that the incidence here falls on the seller or lessor. In their practical operation, however, the taxes at issue here and in *Louisiana Land* operate in precisely the same way: Tennessee law requires that the sales tax be separately stated on the consumer's bill and that it "be collected by the retailer from the consumer insofar as it can be done." Tenn. Code Ann. 67-6-502.[3] In any event, the State's argument, even if factually grounded, would not distinguish *Richfield*, where the Court invalidated a

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[2] The State similarly asserts that the Container Conventions "do not even address, much less forbid, Tennessee's sales tax." Br. in Op. 7. That is not true; by their plain terms, both Conventions set aside "all" taxes imposed by reason of importation. In any event, the State's observation distinguishes neither *Japan Line* (which concerned a tax that was no more "addressed" by the 1956 Convention than is the Tennessee levy) nor *McGoldrick* and *Xerox*, which held general state taxes preempted by federal laws that in terms forbade the imposition only of Customs duties. See Pet. 20-21.

[3] "[T]he burden for the payment of the [sales] tax is meant to be that of the buyer" (*Sam Carey Lumber Co. v. Sixty-One Cabinet Shop, Inc.*, 773 S.W.2d 252, 255 (Tenn. Ct. App. 1989)); if the tax is not collected at the time of sale, either

state tax "levied on retailers" who in turn were "authorized to collect the tax from the consumers." 329 U.S. at 83. Because the State does not (and could not) deny that the goods subject to tax here are in transit and qualify as imports or exports, this case, like *Louisiana Land*, squarely presents the question reserved in *Michelin* and *Washington Stevedoring*: whether such a tax violates the Import-Export Clause. See Pet. 24-25.[4]

For the foregoing reasons and the reasons stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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the State or the seller may later collect the tax from the buyer. See *ibid.*; *Long Equipment Co. v. Keeton*, 736 S.W.2d 611, 613 (Tenn. Ct. App. 1987).

[4] The State asserts that, under its "import-for-export" exemption, Tenn. Code Ann. 67-6-313(a), it would not tax containers that Itel itself brought into and then (without an intervening transfer to a lessee) exported from the State. Br. in Op. 6. In fact, that statute provides no greater protection to interstate and foreign commerce than does the United States Constitution. See *Vector Co. v. Benson*, 491 S.W.2d 612 (Tenn. 1973). In any event, the State's repeated assertion that certain containers escape taxation (Br. in Op. 6, 7) is beside the point; that cannot justify unconstitutional levies on the transfer of containers in Tennessee.

(4)

No. 91-321

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In the Supreme Court of the United States

OCTOBER TERM, 1991

ITEL CONTAINERS INTERNATIONAL CORPORATION,
PETITIONER

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE
OF TENNESSEE

ON PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF TENNESSEE

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTION PRESENTED

The Tennessee Retailers' Sales Tax Act (Tenn. Code Ann. §§ 67-6-101 *et seq.* (1989 & Supp. 1990)) imposes a tax, at the rate of 5.5% of the transaction amount, upon the sale of "tangible personal property at retail in this state" (Tenn. Code Ann. § 67-6-201 (1989)). The statute defines a "sale" as "any transfer of title or possession, or both, exchange, barter, lease, or rental * * * of tangible personal property for a consideration" (*id.* § 67-6-102(23)(A)).

The question presented is whether application of that Act to the lease of shipping containers, delivered at points within the State for use in international transportation of goods, is barred by the Commerce Clause (Art. I, § 8, Cl. 3) or the Import-Export Clause (Art. I, § 10, Cl. 2) of the Constitution of the United States or is pre-empted by the Customs Convention on Containers, May 18, 1956, 20 U.S.T. 301, T.I.A.S. No. 6634, 338 U.N.T.S. 103, acceded to by the United States effective March 3, 1969, or the Customs Convention on Containers, Dec. 2, 1972, S. Exec. Doc. X, 93d Cong., 1st Sess. (1973), 988 U.N.T.S. 43, acceded to by the United States, effective May 12, 1985.

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In the Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-321

ITEL CONTAINERS INTERNATIONAL CORPORATION,
PETITIONER

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE
OF TENNESSEE

ON PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF TENNESSEE

BRIEF FOR THE UNITED STATES
AS AMICUS CURIAE

This brief is submitted in response to the Court's order inviting the Solicitor General to express the views of the United States.

STATEMENT

1. Petitioner is a Delaware corporation with its principal place of business in San Francisco, California. It is engaged in the business of leasing cargo

containers[1] for international use. Petitioner purchases these containers abroad but, pursuant to 19 U.S.C. 1322(a) and regulations thereunder (19 C.F.R. 10.41a(a)(1), (c), (d) and (g)), the containers enter the United States duty-free, as "instruments of international traffic," with a continuous bond given by petitioner guaranteeing payment of all duties, taxes, or liquidated damages that could be assessed for failure to comply with regulations regarding any withdrawal of the containers from international commerce. Pet. App. 2a, 28a-30a.

Petitioner solicits leases for its containers through its offices located in numerous cities in the United States, but has no marketing office in Tennessee. The container leases are formally accepted only at its San Francisco office. The leases are on a per diem basis and restrict the use of containers to international commerce. Subject to this restriction, the lessee determines the route of travel and the period of use. The lessee is allowed to interchange containers at numerous locations around the world and, with certain restrictions, determine where the leased containers are to be returned at the end of the lease. Pet. App. 2a, 30a-31a, 34a.

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[1] The Statement of Stipulated Facts filed by the parties in the Chancery Court describes these containers as follows (Pet. App. 28a) (numbering of sentences omitted): "Containers are specially manufactured steel boxes, 20 or 40 feet long, 8 feet wide and 8.5 or 9.5 feet tall. The containers are uniquely designed so that they may be used to transport goods by a variety of modes, including semi-trailer truck, rail car or oceangoing vessel. The containers are secured to rolling stock while transported overland in international commerce. Because these containers are designed to be used in a variety of transportation modes, they are uniquely suited for use in international commerce."

Prior to August 1, 1985, petitioner had no employees or terminals located in Tennessee. Instead, petitioner made arrangements for its containers to be delivered and picked up in that State at depots operated by other parties. Effective August 1, 1985, petitioner leased a tract of land and buildings in Memphis, Tennessee, where it thereafter maintained a terminal building and work station to receive, store, deliver, and, in some circumstances, repair containers. Petitioner continued to allow customers to interchange containers at other depots in Tennessee, although it had no employees at those points. Pet. App. 2a, 31a.

2. Petitioner was audited by the Tennessee Department of Revenue for the period of January 1983 through November 1986. In December 1986, the Department of Revenue issued an assessment determining that petitioner owed additional sales tax for the period of the audit. Petitioner paid the additional tax, penalty, and interest (in the amount of $382,465) and then filed a request for refund. After this request was denied, petitioner brought this suit for refund. Pet. App. 19a, 24a, 34a-35a.

Upon consideration of testimony and stipulated facts (Pet. App. 27a-37a), the trial court held, as a matter of state law, that the Tennessee Retailers' Sales Tax Act applied only to transactions in which possession of the containers was transferred to lessees in Tennessee and did not apply where lessees took possession outside of the State (*id.* at 20a-21a). Because the tax did not apply to leases where possession of the containers was transferred to lessees outside of Tennessee, the court reduced the assessment of tax, penalty and interest to $158,012 (*id.* at 24a-25a).

With respect to leases where transfer of possession occurred in Tennessee, the court held that application

of the State's sales tax was not unconstitutional (Pet. App. 21a). The court observed (*ibid.*) that, under the criteria of *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1977), businesses are not relieved of their just share of the State's tax burden simply because they are engaged in interstate commerce. The court concluded that the Commerce Clause does not require a different result for leases of the containers involved in this case simply because they were to be used for international, rather than interstate, shipments (Pet. App. 21a-22a).

3. The State accepted the decision of the trial court and did not appeal. On petitioner's appeal, the Supreme Court of Tennessee affirmed the lower court's judgment (Pet. App. 1a-18a). The court rejected petitioner's invocation of *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. 434 (1979), pointing out that (i) in this case the owner and transferor of the leased containers was a domestic corporation, not a foreign corporation subject to taxation, and taxed, by its own government, and (ii) the taxed transaction in this case took place in Tennessee, and was not taxed abroad, so that the Tennessee statute did not effect a multiple tax of a single international transaction (Pet. App. 5a-12a). Because the Tennessee tax otherwise satisfies the tests established by *Complete Auto*, the court concluded that its imposition did not violate the Commerce Clause (Pet. App. 12a-16a). Finally, the court held that the state tax is imposed on the leases of shipping containers, and "not [on] the value of the goods themselves" (*id.* at 18a), and is therefore not subject to challenge under the Import-Export Clause of the Constitution (Pet. App. 16a-18a).

DISCUSSION

1. a. Tennessee provides for petitioner and its containers "police and fire protection, the benefit of a trained work force, and 'the advantage of a civilized society'." *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 627 (1981), quoting *Exxon Corp.* v. *Wisconsin Dep't of Revenue*, 447 U.S. 207, 228 (1980), quoting *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. 434, 445 (1979). Petitioner nonetheless seeks immunity from the Tennessee sales tax on the stated ground that imposition of the tax will increase the cost of American exports and thus impose an "unwarranted" burden on those exports (Pet. 2, 8). The same might be said of the state property taxes [2] on the terminals that petitioner occupies and uses in its business and of the federal [3] and state [4] income taxes on taxable income that includes the rent paid to petitioner by the lessees of its containers. But, as this Court has observed on more than one occasion

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[2] Cf. *Kosydar* v. *National Cash Register Co.*, 417 U.S. 62 (1974); *Joy Oil Co.* v. *State Tax Comm'n*, 337 U.S. 286 (1949); *Empresa Siderurgica* v. *County of Merced*, 337 U.S. 154 (1949).

[3] See *National Paper & Type Co.* v. *Bowers*, 266 U.S. 373 (1924); *Peck & Co.* v. *Lowe*, 247 U.S. 165 (1918).

[4] See *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425 (1980); *United States Glue Co.* v. *Town of Oak Creek*, 247 U.S. 321 (1918). Tenn. Code Ann. § 67-4-806 (1989 & Supp. 1990) imposes an annual tax upon the net earnings of corporations doing business in the State. "Net earnings" is defined in Section 67-4-805 in terms of federal taxable income, with adjustments. For corporations doing business within and outside the State, Sections 67-4-809 and 67-4-811 provide for apportionment, and an apportionment formula.

(*Western Live Stock* v. *Bureau of Revenue*, 303 U.S. 250, 254 (1938))[5]:

> It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business. "Even interstate business must pay its way", * * * and the bare fact that one is carrying on interstate commerce does not relieve him from many forms of state taxation which add to the cost of his business.

The decisions of this Court demonstrate that the same considerations apply to foreign commerce,[6] although special factors such as the inability of the courts to prescribe apportionment where other nations are involved may increase the risk of multiple taxation and thus affect the determination of the "just share of state tax burden." *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. at 444-454. We believe it clear that petitioner's terminals and an apportioned share of petitioner's taxable income from the leases of its containers enjoy no exemption from state taxation. We see no reason why petitioner's delivery of possession of its containers in Tennessee under leases with the carriers who use them should be immune from Tennessee's generally applicable tax on the sale or lease of tangible personal property.

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[5] See, *e.g.*, *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 616 (1981); *Complete Auto Transit* v. *Brady*, 430 U.S. 274, 288 (1977); *Colonial Pipeline Co.* v. *Traigle*, 421 U.S. 100, 108 (1975).

[6] See, *e.g.*, *Mobil Oil Corp.* v. *Commissioner of Taxes*, *supra*; *Washington Revenue Dep't* v. *Stevedoring Ass'n*, 435 U.S. 734 (1978); *Canton R.R.* v. *Rogan*, 340 U.S. 511 (1951).

This case is, in all of its fundamentals, a replica of *Wardair Canada Inc.* v. *Florida Dep't of Revenue*, 477 U.S. 1 (1986), where the Court upheld the application of Florida's tax on the sale of fuel to common carriers, as applied to "fuel used by foreign airlines exclusively in foreign commerce" (*id.* at 4). As in *Wardair*, the tax imposed by Tennessee is upon the transfer, within the taxing State,[7] of an article used in the transportation of goods in foreign commerce. As in *Wardair* (477 U.S. at 8), there can be no doubt that the Tennessee tax satisfies the four-part test set out in *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 279 (1977). And, as in *Wardair*, "there is no threat of multiple international taxation in this case, since the tax is imposed only upon * * * a

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[7] The suggestion (Br. 12) that the Tennessee tax might be duplicated at the site of the execution of the lease— stipulated to be in San Francisco (Pet. App. 30a)—is groundless under the decisions of this Court in *Standard Pressed Steel Co.* v. *Washington Revenue Department*, 419 U.S. 560 (1975), and in *Gwin, White & Prince, Inc.* v. *Henneford*, 305 U.S. 434 (1939). Indeed, as the Court remarked in the latter case (305 U.S. at 440), the tax is "apportioned exactly to the activities taxed." Cf. *Goldberg* v. *Sweet*, 488 U.S. 252 (1989).

Petitioner suggests (Pet. 12) that foreign nations (unrestrained by due process or commerce clauses) *might* duplicate the tax. But if that *possibility* is to govern decision, the result would be a complete immunity from all domestic taxation awarded to all participants in foreign commerce. No decision of this Court has been based upon such reasoning. Moreover, we have been advised by the Department of State that no foreign government has protested, or threatened retaliation against, application of Tennessee's sales tax to transactions involving containers used exclusively in international commerce. Petitioner's speculation that duplicative, retaliatory taxes could be imposed thus lacks any support.

discrete transaction which occurs within one national jurisdiction only" (477 U.S. at 9).

The Court in *Wardair* held specifically that nothing in *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. 434 (1979)—on which petitioner principally relies (Pet. 9-16)—served to invalidate the State's tax on the sale of aircraft fuel to foreign airlines. See 477 U.S. at 13. For the same reasons identified by this Court in *Wardair*, *Japan Line* also has no bearing on the present case. In particular, in contrast to the present case, which involves a sales tax on a transfer occurring within a single State, *Japan Line* involved an annual property tax on equipment having no fixed location. As the Court held in *Japan Line*, when that occurs within our borders, no jurisdiction may tax the instrumentality in full; apportionment is the rule. 441 U.S. at 447. See also *Braniff Airways, Inc.* v. *Nebraska State Board*, 347 U.S. 590 (1954); *Standard Oil Co.* v. *Peck*, 342 U.S. 382 (1952); *Union Refrigerator Transit Co.* v. *Kentucky*, 199 U.S. 194 (1905). But apportionment cannot be assured when foreign nations are involved. In *Japan Line*, the containers were owned, based, and fully taxed in Japan. 441 U.S. at 451-452. It was under those circumstances that Los Angeles County was required to yield to avoid multiple taxation—the decision acknowledged a prior right to tax by Japan. But nothing in *Japan Line* suggests that if containers were owned and based in the United States, the State (or States, on an apportioned basis) that sought to impose a property tax would be required to yield to some other country that sought to tax on the basis of temporary presence. For the same reasons that foreign nations possess a prior right to tax foreign-owned instrumentalities of foreign commerce, so too does this Nation and its States possess the right

to tax the domestically owned instrumentalities of commerce.

b. Petitioner contends (Pet. 17-23) that a national rule proscribing state taxation of containers has been established under the 1972 Customs Convention on Containers, S. Exec. Doc. X, 93d Cong., 1st Sess. (1973), 988 U.N.T.S. 43 (Pet. App. 38a-41a), adhered to by the United States in 1985, and its predecessor, the 1956 Customs Convention on Containers, 20 U.S.T. 301, T.I.A.S. No. 6634, 338 U.N.T.S. 103 (Pet. App. 41a-43a), adhered to by the United States in 1969 (Pet. App. 13a-23a). As both the title of the Conventions and their definition of "import duties and taxes" (*id.* at 39a, 41a) indicate, however, the Conventions relate only to customs duties on containers, and provide for temporary admission duty-free. The States, of course, do not, and can not, impose customs duties, either on the containers or on the goods they may contain. There is no reason why a convention on the subject of customs duties should be thought to relate to generally applicable sales taxes—a now almost universal form of domestic taxation by the States. As discussed above, domestically owned containers are properly the subject of domestic taxation, and nothing in the Customs Convention on Containers alters or vitiates that principle.

2. Petitioner invokes not only the Commerce Clause, but also the Import-Export Clause (Art. I, § 10, Cl. 2) of the Constitution, and asserts that the decision below conflicts with *Richfield Oil Corp.* v. *State Board of Equalization*, 329 U.S. 69 (1946), and with *Louisiana Land & Exploration Co.* v. *Pilot Petroleum Corp.*, 900 F.2d 816 (5th Cir.), cert. denied, 111 S. Ct. 248 (1990) (Pet. 9, 23-27). There is no conflict and no violation of the Import-Export clause.

In both the *Richfield* and the *Louisiana Land* cases, a seller of oil delivered, as agreed, a large quantity of oil f.o.b. into a waiting tanker—in *Richfield*, a tanker in the Los Angeles harbor owned by the New Zealand Navy and destined for Auckland, New Zealand; in *Louisiana Land*, a tanker situated in the Mobile, Alabama, harbor and destined for Halifax, Nova Scotia. This Court in *Richfield* and the Fifth Circuit in *Louisiana Land* held that the Import-Export Clause barred the local government from collecting its generally applicable tax on those export sales of oil.

It is instructive to compare those two cases with *Joy Oil Co.* v. *State Tax Comm'n*, 337 U.S. 286 (1949), and *Empresa Siderurgica* v. *County of Merced*, 337 U.S. 154 (1949), where, in each case, a foreign purchaser purchased in this country property for export to its country—in *Joy Oil*, 1,500,000 gallons of gasoline purchased at a Grand Rapids refinery for export to Canada; in *County of Merced*, a cement plant in Merced County, California, to be disassembled, packaged, and shipped to South America. In each case, tax day for the assessment of local property taxes arrived after much of the purchased property had started its journey but was being held temporarily before crossing the water's edge. In each case, this Court upheld application of the local property tax to that part of the property within the geographic limits of this country.

It has been suggested [8] that this Court's decision in *Michelin Tire Corp.* v. *Wages*, 423 U.S. 276 (1976), abandoning the "original package" doctrine with respect to imports in favor of enforcement of generally applicable state and local taxes, should lead the Court

[8] See, *e.g.*, L. Tribe, *American Constitutional Law* 472-473 (2d ed. 1988).

to abandon the perhaps analogous line—sometimes styled the "final journey" line—drawn in the cases relating to exportation. If the "final journey" test were applied in this case, it would be clear that the transfer of possession of empty containers in inland Tennessee did not mark the beginning of the final journey of loaded containers on ships in international trade. It is not, however, necessary to deal with that question in this case.

This case involves no exports. The American-owned truck or railroad car that carries goods from points in this country to consignees in Canada or Mexico *carries exports, but is not itself an export.* The same is true of American-owned ships or airplanes carrying goods to more remote consignees. The goods will be left at their foreign destinations while the carrier, not itself an export, returns for further voyages. The same is true, of course, of the containers that petitioner leases for the carriage of goods out of United States—containers that will be returned to petitioner for further leases and further voyages. The goods are exports, but the containers are not.

This difference was recognized by this Court in *Canton R.R.* v. *Rogan*, 340 U.S. 511 (1951). The railroad in that case operated solely within Baltimore, moving freight between its marine terminal at the port of Baltimore and connecting railroads. It claimed, invoking the *Richfield* case, that some $700,000 of its gross receipts of $1,588,744 were exempt from Maryland's tax on the gross receipts of steam railroads on the ground that that figure represented the proceeds of handling imports and exports. This Court rejected that claim, stating (*id.* at 513-514):

> If this were a tax on the articles of import and export, we would have the kind of problem presented in * * * *Richfield Oil Corp.* v. *State Board*

> * * * and *Joy Oil Co.* v. *State Tax Comm'n* * * *. But the present tax is not on the articles of import and export[.] * * * The difference is that in the present case the tax is not on the *goods* but on the *handling* of them at the port.

As the Court concluded (*id.* at 515), "if the handling of the goods at the port were part of the export process so would hauling them to or from distant points or perhaps mining them or manufacturing them."

The Tennessee Supreme Court was thus correct in concluding (Pet. App. 18a) that application to cargo containers of a generally applicable tax on the sale or leasing of tangible personal property is not a tax on exports simply because the leased containers may be used in handling goods that are to be exported.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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No. 91-321

In the Supreme Court of the United States

OCTOBER TERM, 1991

ITEL CONTAINERS INTERNATIONAL CORPORATION,
PETITIONER

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE,
STATE OF TENNESSEE, RESPONDENT

On Petition for a Writ of Certiorari to the Tennessee Supreme Court

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SUPPLEMENTAL BRIEF FOR PETITIONER

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SUPPLEMENTAL BRIEF FOR PETITIONER

Pursuant to Rule 15.7 of the Rules of this Court, this brief is filed in response to the brief submitted by the United States as *amicus curiae*.

In its filing, the government does not take issue with the proposition that the questions presented in the petition are recurring ones of considerable importance. Nor does it deny that the Tennessee tax will both increase the cost of American exports and discourage the use of American containers. Nor, for that matter, does the government make any attempt to defend the analysis of the court below as to *any* of the questions presented. As we understand its submission—and there are elements of the government's reasoning that we frankly find opaque—the government nevertheless opposes review because it believes that the Tennessee Supreme Court could have upheld Tennessee's tax on grounds that the court below either did not advance or expressly rejected. This argument rests in equal parts on a misreading of our position and of the decision below, and on a misstatement of the controlling law. Needless to say, we do not think that the government has offered any substantial reason for this Court to deny review.

A. The Commerce Clause

1. The government begins its discussion of the Foreign Commerce Clause with the boilerplate observation that interstate commerce must pay its own way (Br. 5-6), suggesting that Itel seeks complete immunity from state taxation "on the stated ground that imposition of the tax will increase the cost of American exports." Br. 5. That suggestion misstates our position. We noted the effect of the Tennessee tax upon American commerce simply to emphasize the practical importance of the case (see Pet. 8-9)—a point that, it again bears emphasis, the government does not dispute. Our *legal* submission is that the court below erred in holding that state sales and similar transaction taxes are wholly im-

mune from attack under the Foreign Commerce Clause, even when those levies fall directly on instrumentalities of foreign commerce. See Pet. 11-16.

2. While the government does not expressly address this question, it does contend that review is unwarranted because "[t]his case is, in all of its fundamentals, a replica of *Wardair Canada Inc.* v. *Florida Dep't of Revenue*, 477 U.S. 1 (1986)." Br. 7. This contention is nothing short of mystifying. As we noted in the petition (at 11), Tennessee's sales tax on containers certainly is similar to (although more difficult to defend than) the Florida sales tax on aviation fuel at issue in *Wardair*. But the government's contention that *Wardair* controls this case is simply wrong. The Court affirmed the constitutionality of the Florida tax because, by treaty and executive agreement, "the Federal Government has affirmatively decided to permit the States to impose these sals taxes on aviation fuel." *Wardair*, 477 U.S. at 12. See *id.* at 3-4, 9-10. Here, of course, the government does not (and could not) contend that the Tennessee tax benefits from a similar affirmative federal authorization. In fact, the *Wardair* Court expressly *reserved* the question presented in this case, explaining that "there is no need for us to consider, and nothing in this opinion should be understood to address, whether, in the absence of these international agreements, the Foreign Commerce Clause would invalidate Florida's tax." *Id.* at 13.

The government similarly contends (Br. 8) that *Wardair*'s analysis demonstrates the inapplicability of *Japan Line* to this case. Again, this contention involves a patent misstatement of the *Wardair* holding. The government evidently has in mind the following statement in *Wardair*:

> In *Japan Line*, 441 U.S., at 451, we explained that Foreign Commerce Clause analysis requires that a court ask whether a state tax "prevents the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'" But we never suggested in that case or any other that the Foreign Commerce Clause *insists* that the Federal Government speak with any particular voice.

477 U.S. at 13. That statement, of course, related to the *Wardair* Court's conclusion that the Florida tax had been affirmatively authorized by the United States. Because the United States here has, if anything, acted to preclude the imposition of state taxes on containers, the reasoning of *Wardair* says absolutely nothing about *Japan Line*'s applicability in this case.

3. While evidently recognizing that the Tennessee tax would pose constitutional problems if imposed on a foreign domiciliary (see Br. 8), the government also suggests that the levy may be upheld on the ground that Itel is domiciled in the United States; the government asserts that, "[f]or the same reasons that foreign nations possess a prior right to tax foreign-owned instrumentalities of foreign commerce, so too does this Nation and its States possess the right to tax the domestically owned instrumentalities of commerce." Br. 8-9. We certainly agree that nothing in the Foreign Commerce Clause precludes the United States from favoring foreign over domestic firms. But the government's surprising suggestion that a *state* may discriminate against citizens of other states and in favor of foreign domiciliaries does not support denial of review for several reasons.

First, the Tennessee court expressly "decline[d] to consider the domicile of the owner of the containers as relevant" (Pet. App. 8a) because it believed that a distinction between foreign and domestic domiciliaries would itself be constitutionally suspect. As a consequence, the only question presented by the Tennessee court's decision is whether, as the court held, transaction taxes (on foreign as well as domestic taxpayers) automatically escape regulation under the Foreign Commerce Clause. By urging denial of review on the ground that Itel is a United States domiciliary, the government thus is telling this Court that it need not consider the case because the court below could have upheld the tax on a ground that it in fact expressly rejected, while urging the Court to

leave intact a decision that states a rule—the *per se* validity of transaction taxes—that cannot be reconciled with the Constitution.[1]

Second, the dangers of duplicative taxation and retaliation that concerned the Court in *Japan Line* are present here, notwithstanding Itel's status as a U.S. domiciliary. As we explain in the petition (at 12-13)—and as the government expressly (albeit grudgingly) acknowledges (Br. 7 n.7)—other nations could impose use or similar taxes that effectively duplicate Tennessee's levy on sales.[2] And while the government dismisses the possibility that the risk of multiple international taxation could invalidate a state tax (at Br. 7 n.7), the Court in *Japan Line* expressly declined to decide in what "circumstances the mere *risk* of multiple taxation would invalidate a state tax, or whether this risk would be evaluated differently

[1] In making this argument, it appears that the government misunderstood the decision below. The government's statement of the case reports: "[t]he court [below] rejected petitioner's invocation of *Japan Line* * * * pointing out that * * * in this case the owner and transferor of the leased containers was a domestic corporation, not a foreign corporation subject to taxation, and taxed, by its own government." Br. 4. While the state court did "point[] out" Itel's domestic domicile, it did so only in the course of labeling that domicile legally irrelevant to the issue presented here.

[2] Somewhat inconsistently, the government also quotes *Wardair* as standing for the proposition that " 'there is no threat of multiple international taxation in this case, since the tax is imposed only upon * * * a discrete transaction which occurs within one national jurisdiction only.' " Br. 7-8, quoting *Wardair*, 477 U.S. at 9. In fact, the quoted language from *Wardair* was reciting a party's concession rather than the Court's own analysis. In any event, as we note in the petition (at 12-13 n.8), the United States itself explained the special circumstances in *Wardair* that eliminated the risk of duplicative taxation in that case: "far from being able to tax the event of sale, foreign nations could not purport to tax even the fuel itself, which typically will be consumed in international air space en route from the United States." U.S. Br. in support of prob. jur., No. 84-902, at 31. That is not the case here; as we demonstrate in the petition (at 12-13), there are a variety of duplicative taxes that could be imposed upon containers.

in foreign, as opposed to interstate, commerce." 441 U.S. at 452 n.17 (emphasis in original).

As for the prospect of retaliation by our trading partners, we noted in the petition (at 14-15) that, under Tennessee law, the tax must be separately stated on the bill submitted by the lessor to the lessee; the law also provides that the tax "shall be collected by the retailer from the consumer insofar as it can be done." Tenn. Code Ann. 67-6-502. This requirement is mandatory. See *Hooten* v. *Carson*, 209 S.W.2d 273, 275 (Tenn. 1948). Itel thus acts as a tax collector for the State. In this setting, its domicile is of little importance; the tax burden is (and by law must be) borne by its customers, 80% of whom are foreign domiciliaries. And because these customers (as well as their governments) will know that they are paying the tax, the problems of retaliation addressed by *Japan Line* are fully present here.[3]

Third, the suggestion that states may discriminate against domestic and in favor of foreign taxpayers—a contention that the government has advanced unsuccessfully in the past (see No. 78-1577, U.S. Br. at 8)—is one that has closely divided the Court and that has not yet been resolved. In *Japan Line* itself the Court reserved the question whether domestically owned instrumentalities of international commerce are subject to state taxation. 441 U.S. at 444 n.7. Justice Powell, writing for the three Members of the Court who reached the question, subsequently concluded that a state cannot discriminate against a corporation domiciled in another state and "in favor of an overseas corporation" unless it receives "explicit congressional authorization." *Container Corp.* v. *Franchise Tax Board*, 463 U.S. 159, 203 (1983) (Powell, J., dissenting). See *id.* at 204 n.6. And in *Zee Toys, Inc.* v. *County of Los Angeles*, 149

[3] While the government notes (at Br. 7 n.7) that no foreign nation has yet threatened retaliation because of Tennessee's tax, that is because this test case is the first in which the tax has been imposed. The government does not deny that, as we explain in the petition (at 14 & n.10), none of our trading partners taxes the transfer of containers.

Cal. Rptr. 750, 754, 755 (Cal. Ct. App. 1978), a state court held that the "exemption of goods of foreign origin" from California's ad valorem property tax, which gave goods in foreign commerce "a competitive advantage over interstate goods, is a regulation of interstate and foreign commerce in violation of the Commerce Clause." That holding was affirmed by an equally divided Court. *Sears, Roebuck & Co.* v. *County of Los Angeles*, 449 U.S. 1119 (1981). In this setting, the government is hardly advancing a noncontroversial ground in support of the judgment below.

B. The Container Conventions

In opposing review of the preemption question presented in the petition, the government asserts (Br. 9) that neither the 1972 nor the 1956 Container Convention applies here because they "relate only to customs duties on containers" and "[t]here is no reason why a convention on the subject of customs duties should be thought to relate to generally applicable sales taxes." Again, we find this submission baffling: it is manifestly inconsistent with the plain language of the Conventions, with this Court's holding in *Japan Line*—and with the government's own position in that case.

The government cites but (perhaps not surprisingly) does not quote the Conventions' definitions of prohibited "import duties and taxes." The 1972 Convention provides that the term includes "Customs duties *and all other duties, taxes, fees and other charges* which are collected on, *or in connexion with*, the importation of goods, but not including fees and charges limited in amount to the approximate cost of services rendered." 988 U.N.T.S. 44 (emphasis added). The 1956 Convention defines the same term to mean "*not only Customs duties but also all duties and taxes whatsoever* chargeable by reason of importation." 20 U.S.T. 304 (emphasis added). There is no ambiguity here: the Conventions reach far beyond Customs duties.

Any doubt on that score is dispelled by *Japan Line*, which addressed a generally applicable state property

tax that was no more a Customs duty than the Tennessee levy at issue here. But the Court, explaining that "[t]he Convention reflects a national policy to remove impediments to the use of containers as 'instruments of international traffic,'" had no difficulty concluding that "California's tax * * * will frustrate attainment of federal uniformity." *Japan Line*, 441 U.S. at 453. The Court reached this conclusion, moreover, at the urging of the United States, which pointed to the 1956 Convention as establishing that "disparate state laws offend a perceived need for federal uniformity" (No. 77-1378, U.S. Br. 27 n.20)—and which concluded that the 1956 Convention preempted generally applicable state taxes: "In the instant case, a comprehensive arrangement of federal regulation has been adopted; *this arrangement precludes general state taxation* of foreign-owned instruments of commerce, and of sea-borne containers in particular." *Id.* at 22-23 (emphasis added). The government reasoned that the general state tax at issue "would frustrate accomplishment of a federal objective" (*id.* at 28) and therefore "conflict[] with the spirit and design of the federal scheme." *Id.* at 29 (footnote omitted). As the proscription on local regulation of containers has become considerably *stricter* since that time with the ratification of the 1972 Convention (see Pet. 18-19), the change in the United States' position is difficult to understand.

Equally curious is the government's failure to address *Xerox Corp.* v. *Harris County*, 459 U.S. 145 (1982), and *McGoldrick* v. *Gulf Oil Corp.*, 309 U.S. 414 (1940), discussed in the petition (at 20-23), which respectively invalidated state sales and property taxes imposed on goods stored under bond in Customs bonded warehouses. As we explain in the petition (at 20), the statutes governing bonded warehouses, which were intended to encourage the use of American ports, in terms preclude the imposition only of Customs duties on such goods. The *Xerox* and *McGoldrick* Courts nevertheless struck down generally applicable state taxes, reasoning that "the purpose of the Congressional regulation of the commerce would

fail if the state were free at any stage of the transaction to impose a tax which would lessen the competitive advantage conferred on the importer by Congress." *McGoldrick*, 309 U.S. at 429. See *Xerox*, 459 U.S. at 153. Precisely the same analysis applies to the Container Conventions, which were intended to encourage the use of containers in international commerce. See Pet. 21. Indeed, despite its failure to identify the reasons for preemption here, the government recognized as much at the time of *Japan Line*, telling the Court that the bonded warehouse statutes are "analogous" to the 1956 Convention (No. 77-1378, U.S. Br. at 25) and concluding that "[t]he rationale of *McGoldrick* applies here as well." *Id.* at 27 (footnote omitted). We think that the United States got it right the first time.

C. The Import-Export Clause

Insofar as we understand its submission, the government opposes review of the Import-Export Clause question presented in the petition—which asks whether the Clause prohibits the imposition of state taxes on imports or exports while they are in transit—on the ground that containers that are brought into and shipped out of the United States are not imports or exports at all. Again, this is not the ground relied upon by the court below, which viewed *Michelin Tire Corp.* v. *Wages*, 423 U.S. 276 (1976), as holding the transitory character of the goods at issue to be immaterial and which proceeded to apply the *Michelin* test to Tennessee's tax. See Pet. 25-26. As a consequence, whatever the merits of the government's position on the status of containers as imports and exports, it plainly is incorrect in stating (at Br. 9) that the decision below does not conflict with *Richfield Oil Corp.* v. *State Board of Equalization*, 329 U.S. 69 (1946), and *Louisiana Land & Exploration Co.* v. *Pilot Petroleum Corp.*, 900 F.2d 816 (5th Cir.), cert. denied, 111 S. Ct. 248 (1990), both of which found it fatal to a state sales tax that the goods were in transit

to a foreign country at the time the tax attached. See Pet. 23, 24-25.[4]

In any event, the government's contention—that a container is not protected under the Clause because it "*carries exports, but is not itself an export*" (Br. 11 (emphasis in original))—appears to have been weaved out of whole cloth. The only authority offered by the United States for its position, *Canton R.R.* v. *Rogan*, 340 U.S. 511 (1951), is self-evidently beside the point. There, the Court upheld a gross receipts tax imposed on revenues "derived from services" provided by a railroad in the form of switching, storage, wharfage, weighing, and providing a crane for use in loading and unloading. See *id.* at 512-513. Distinguishing *Richfield*, the Court explained that "[t]he difference is that in the present case the tax is not on the *goods* but on the *handling* of them at the port." *Id.* at 514 (emphasis in original). Here,

[4] The government does appear to hint that *Richfield* and *Louisiana Land* are distinguishable here, declaring that "[i]t is instructive to compare those two cases with *Joy Oil Co.* v. *State Tax Comm'n*, 337 U.S. 286 (1949), and *Empresa Siderurgica* v. *County of Merced*, 337 U.S. 154 (1949)." Br. 10. While we would never suggest that this Court's decisions are anything other than "instructive," we admit to some confusion at the government's point here. In both *Joy Oil* and *County of Merced*, the Court upheld the imposition of state property taxes on goods that were held in this country prior to export. In both cases, however, the Court emphasized that the goods "might have been diverted to domestic markets * * *. Neither the character of the property nor any event equivalent to its redelivery to a common carrier made export certain for all practical purposes." *Joy Oil*, 337 U.S. at 288. See *County of Merced*, 337 U.S. at 157 (goods "had not yet been delivered to any carrier for export or otherwise started on its journey on the tax date. It might still have been diverted into the domestic market. * * * On the tax date the movement to foreign shores had neither started nor been committed"). Here, in contrast, the containers were not subjected to tax *until* they were delivered to a common carrier for transport overseas. And the "character" of the property made it certain that the containers would leave the country, since they obtained their duty-free status only upon Itel's undertaking that they would be used *exclusively* in international commerce. *Joy Oil* and *County of Merced* thus seem strongly to support Itel's position.

of course, the Tennessee sales tax is not imposed on any services provided by Itel, but directly on the containers. And as we explain in the petition (at 26), the Court has "always considered a tax on the sale of goods to be a tax on the goods themselves." *Department of Revenue* v. *Ass'n of Washington Stevedoring Cos.*, 435 U.S. 734, 756 n.21 (1978).

Indeed, the government's position makes no logical sense. It cannot be dispositive that containers are used to facilitate the transport of other goods; the same is true of packaging materials, which inarguably may be imports or exports. Nor does it matter that the containers may return to this country; goods that are leased (rather than sold) for use across national borders are treated as imports or exports, even though they will return to the country of origin.[5] It thus is not surprising that containers, unlike the self-propelled airplanes and ships to which the government analogizes them (Br. 11), would be subject to federal Customs duties as imports were they not exempted by the Container Conventions. (That, of course, is the precise point of the Conventions.) The United States has offered no reason to believe that containers should be treated differently for purposes of the Import-Export Clause. As the government also does not deny that the issue presented here is an important and recurring one that this Court repeatedly has reserved, review plainly is warranted.

For the foregoing reasons and the reasons stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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[5] Goods that are leased in foreign commerce may be treated as duty free imports by the Customs Service. See *Marposs Gauges Corp.* v. *United States*, 9 C.I.T. 193 (1985). And the United States treats goods leased in international commerce as export property for purposes of income taxation. See *Westinghouse Electric Corp.* v. *Tully*, 466 U.S. 388, 391 n.1 (1984); 29 U.S.C. 993(a)(1)(B).

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No. 91-321

In the Supreme Court of the United States

OCTOBER TERM, 1991

ITEL CONTAINERS INTERNATIONAL CORPORATION,
PETITIONER

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE,
STATE OF TENNESSEE, RESPONDENT

On Writ of Certiorari to the Supreme Court of Tennessee

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QUESTIONS PRESENTED

1. Whether the Customs Conventions on Containers preempt the imposition of a state sales tax upon the lease of cargo containers that enter the United States under Customs bond and are used exclusively in foreign commerce.
2. Whether the imposition of such a tax is prohibited by the Foreign Commerce Clause.
3. Whether the Import-Export Clause prohibits the imposition of a state sales tax on imported or exported goods while they are in transit.

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BRIEF OF PETITIONER

OPINIONS BELOW

The opinion of the Supreme Court of Tennessee is reported at 814 S.W.2d 29. It is reprinted in the appendix to the petition for a writ of certiorari at 1a-18a. The unreported opinion of the Tennessee Court of Chancery appears at Pet. App. 19a-26a.

JURISDICTION

The judgment of the Tennessee Supreme Court was entered on April 22, 1991. On July 10, 1991, Justice Stevens extended the time within which to file the petition to and including August 21, 1991. The petition was filed on August 21, 1991, and the Court granted the petition on February 24, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. 1257(a).

CONSTITUTIONAL, STATUTORY, AND REGULATORY PROVISIONS INVOLVED

The relevant portions of the following constitutional, statutory, and regulatory provisions are reproduced in the appendix to the petitition at 38a-44a: the Foreign Commerce Clause (Art. I, § 8, Cl. 3), the Import-Export Clause (Art. I, § 10, Cl. 2) and the Supremacy Clause (Art. VI, Cl. 2) of the United States Constitution; the Customs Convention on Containers, Dec. 2, 1972, [1985] 988 U.N.T.S. 43; the Customs Convention on Containers, May 18, 1956, [1969] 20 U.S.T. 301; 19 U.S.C. 1322(a); 19 C.F.R. 10.41a; 19 C.F.R. Pt. 115; and Tenn. Code Ann. 67-6-102(23)(A) (1989).

STATEMENT OF THE CASE

This case represents a collision between the power of the Federal Government and of a State to regulate foreign commerce. Tennessee has imposed a sales tax on the lease of Customs bonded and sealed cargo containers used exclusively and continuously in foreign commerce. The United States and 58 other nations have signed two treaties that prohibit the imposition of taxes in connection with the importation of cargo containers. Tennessee is the only State—and indeed the only subnational unit within the borders of the 59 signatory nations to these treaties—that imposes such a tax. Tennessee's sales tax assessment is prohibited by the 1956 and 1972 Customs Conventions on Containers (the "Container Conventions") and is inconsistent with the objectives promoted by the comprehensive scheme of regulation emanating from the Conventions.

Further, Itel contends that the tax violates the Foreign Commerce and Import-Export Clauses of the United States Constitution. Because Tennessee taxes the full value of a transaction with substantial taxable nexus around the globe, it creates a risk of international multiple taxation. In addition, most container lessees, who

in large part absorb the tax, are foreign domiciliaries. The exaction of the tax therefore both creates an asymmetry in international taxation of containers and threatens to prompt retaliation by our trading partners against American firms.

The Container Revolution. Cargo containers are specifically manufactured steel boxes (typically eight feet high, eight to 9.5 feet wide and between eight and 40 feet long), that are used as articles of transport equipment. See *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 436 n.1 (1979). Because they are reusable, may be loaded and unloaded mechanically, and are designed to be carried by truck, rail and oceangoing vessel, containers have greatly reduced the cost of shipping cargo. See Simon, *The Law of Shipping Containers*, 5 J. Mar. L. & Com. 507, 513 (1974). Containerization provides a number of significant economies in the transport of cargo: elimination of intermediate repacking and handling between the points of origin and destination; ease of storage on oceangoing vessels; reduction of damage to cargo resulting from manual handling; elimination of expensive, disposable packaging; and speedy loading and discharging, which reduces the idle time of a vessel and crew while in port. See Simon, *supra*, at 510-13.

While permanent, reusable cargo containers were in use for many years, "[w]ith the container revolution of the 1960's, large containers and specially-built container ships to accommodate them came into use." *Summary Record of the First Plenary Meeting*, [1972] U.N. Doc. E/CONF.59/SR.1 at 7 (United Nations/IMCO Conference on International Traffic, considering the 1972 Convention). This revolution, described as "[one] of the most important technological developments in the transportation of goods by sea since steam replaced sail" (see Simon, *supra*, at 507), has fueled a boom in international imports and exports. "It would be difficult to overestimate the impact on virtually all phases of international

trade of the dramatic expansion * * * of the use of large, intermodal freight containers." Sen. Comm. on Foreign Relations, Exec. Rep. No. 33, 94th Cong., 2d Sess. 4 (1976) (statement of John B. O'Loughlin, Acting Assistant Commissioner (Operations), U.S. Customs Service).

The United States is a world leader in container use; containers now provide the principal means for marine transportation of U.S. imports and exports. Containers carried 60% of the value of American marine imports and 52% of the value of American marine exports in 1990. Bureau of the Census SM705. The value of American goods exported by container in 1990 exceeded $84 billion. *Ibid.* Containers were used for the marine transport of a variety of crucial American exports in 1990: 59% of the value of exported chemicals and related products, 61% of the value of exported machinery and transport equipment, 69% of the value of manufactured goods and 89% of the value of exported beverages and tobacco were carried in containers. *Ibid.* More than 25% of these containers, with a replacement value of approximately $3.2 billion, are owned by firms domiciled in the United States. Br. of Cronos Containers, *et al.*, at 4.

The Container Conventions. The United States and many of its trading partners have for several decades provided special benefits to containers by treaty. In fact, the "need for providing for the temporary importation of containers free of import duty and taxes, and for harmonizing or unifying technical provisions applicable to containers used for transport under Customs seal was felt in Europe well before the advent of the 'Container Revolution.'" U.N. Doc. E/CONF.59/2 at 1 (Feb. 22, 1971). Twelve European nations originally signed the 1956 Customs Convention on Containers (the "1956 Convention"), May 18, 1956, [1969] 20 U.S.T. 301. The 1956 Convention entered into force with respect to the United States on March 3, 1969.

Article 2 of the 1956 Convention requires each signatory nation to "grant [containers] temporary admission free of import duties and taxes and free of import prohibitions and restrictions." 20 U.S.T. at 304. The Convention defines the term "import duties and import taxes" to mean "not only Customs duties, but also all duties and taxes whatsoever chargeable by reason of importation." *Ibid.* The legal fiction of temporary importation thus prevents containers from entering the domestic commerce of any signatory nation.

The 1972 Convention, which entered into force with respect to the United States on May 12, 1985,[1] expanded the prohibition of container taxation. The 1972 Convention's definition of prohibited "import duties and taxes" encompasses "Customs duties *and all other duties, taxes, fees and other charges* which are collected on, or in connexion with, the importation of goods, *but not including fees and charges limited in amount to the approximate cost of services rendered.*" 988 U.N.T.S. at 44 (emphasis added). The 1972 Convention requires strict regulatory compliance to qualify for these benefits, generally providing that containers must be re-exported within three months of their importation (see art. 4, *id.* at 45) and limiting their use in internal traffic (see annex 3, *id.* at 52).[2] Including the United States, 59 nations now are signatories to one or the other of the Container Conventions. See U.S. Dept. of State, *Treaties in Force* 303-305 (1990).

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[1] The United States signed the 1972 Convention on December 5, 1972. Upon entry into force, the 1972 Convention replaced the 1956 Convention in relations between the parties to the 1972 Convention. See 1972 Convention, 988 U.N.T.S. at 48.

[2] The 1972 Convention also provides for the admission of container parts and accessories (art. 10-11, 988 U.N.T.S. at 46), the approval of containers used to transport goods under Customs seal (art. 12, *id.* at 47; Annex 5, *id.* at 61-67), the marking of containers (Annex 1, *id.* at 51-52), the obligations of container owners (Annex 2, *id.* at 52), and the design of containers (Annex 4, *id.* at 52-61).

The Conventions have been implemented in the United States by statute and regulation. The Secretary of the Treasury, acting pursuant to 19 U.S.C. 1322(a), has designated containers as "instruments of international traffic" that are excepted from application of the Customs laws. 19 C.F.R. 10.41a(a)(1), (3). To receive this special treatment, however, a container owner must provide assurances that its containers will not be used in interstate or intrastate commerce; if the containers are diverted to point-to-point local use within the United States, the owner must make entry and pay the applicable Customs duty. Each owner must post a continuous bond with the Customs Service to secure compliance with this undertaking. 19 C.F.R. 10.41a(a), (c), 113.66. In addition, 19 C.F.R. pt. 115 implements the 1972 Convention's procedures for the certification and approval of containers used in transporting goods under Customs seal. Compliance with these procedures allows steamship lines to move containers from the point of loading to the ultimate destination without the presentation of papers to, or inspection by, Customs officials.[3]

Itel's Business. Itel[4] is a Delaware corporation with its principal place of business in California. Stip. 4, Pet. App. 27a.[5] During the relevant period, it leased cargo

[3] "It is not surprising that containerization * * * has impacted on worldwide customs procedures. Containers are designed for uninterrupted movement of large unit loads of goods over potentially great distances without the need for customs authorities to carry out their controls using traditional methods. Obviously, if containers were opened and the goods examined at every frontier or port, the efficiency gained through containerization would be nearly completely lost." Exec. Rep. No. 94-33, *supra*, at 4.

[4] Itel's Rule 29.1 statement appears in the Petition at ii.

[5] Itel submitted an extensive stipulation of facts, presented testimony of two witnesses and introduced 27 exhibits which were admitted without objection at trial. Stip. 92; Trial Transcript ("Tr.") 21, 22, 52, 53, 87. The Tennessee Department of Revenue offered no testimony or exhibits in rebuttal. Tr. 99.

containers that were used exclusively in foreign commerce by steamship lines. The containers were manufactured and purchased abroad by Itel, and entered the United States certified for the transport of goods under Customs seal. Itel posted a continuous bond with the Customs Service undertaking not to withdraw its containers from foreign commerce. All of Itel's leases accordingly restricted use of the containers to international commerce. Stip. 72-73, Pet. App. 34a. The leases were solicited and negotiated through marketing offices in California, Texas, Illinois, New Jersey, South Carolina and Washington; none of the leases during the relevant period was solicited, negotiated or executed in Tennessee. Stip. 3, 41; Pet. App. 27a, 31a. In addition, Itel operated container terminals and made use of so-called "third-party" terminals—facilities operated by independent contractors that tendered delivery and accepted returns of containers —worldwide.

Itel operated one terminal and used several third party terminals in Tennessee.[6] Containers were delivered at those points to common carriers hired by Itel's lessees. Eighty percent of the lessees who accepted delivery of Itel's containers in Tennessee were international steamship lines domiciled in foreign countries, including companies domiciled in Australia, Colombia, France, Germany, Iceland, Israel, New Zealand, Norway, Singapore, Sweden, Switzerland, the United Kingdom, and Venezuela. Tr. 31-33. While each container initially was used to export American goods to foreign ports, most containers were used continuously in multiple import-export shipments. All of Itel's leases culminated with an import

[6] For the greater part (January 1, 1983-June 30, 1985) of the audit period, Itel did not have any employees or terminals located in Tennessee. Stip. 31, Pet. App. 31a. Before July 1, 1985, Itel allowed its containers to be delivered and picked up at two or three third party depots located in Tennessee. Stip. 32, Pet. App. 31a. During the latter portion of the audit period, Itel leased real property and buildings located in Memphis and employed four persons to operate the terminal. Stip. 33-35, Pet. App. 31a.

shipment terminating in a Customs Convention signatory nation; 61% of the leases concluded with an importation into the United States.[7]

The Assessment. In 1986, the Tennessee Department of Revenue assessed $382,465 in sales taxes, penalties and interest on the proceeds earned from the lease of containers that Itel delivered in Tennessee to international carriers.[8] Tennessee's 5.5% sales tax is imposed on "any transfer of title or possession, or both, exchange, barter, lease or rental * * * for a consideration." Tenn. Code Ann. 67-6-102(23)(A) (1989).[9] While Itel is obligated to collect the tax from its lessees "insofar as it can be done" (Tenn. Code Ann. 67-6-502 (1971)), the legal incidence of the tax falls on Itel, and only Itel may contest its imposition. *See Beare Co. v. Olsen*, 711 S.W.2d 603, 605 (Tenn. 1986). Itel accordingly paid the tax under protest and began this action for a refund, challenging the constitutionality of the tax under the Commerce, Import-Export, and Supremacy Clauses of the United States Constitution. The Tennessee Chancery Court reduced the assessment on state law grounds but rejected the federal constitutional claims, sustaining a revised assessment of $158,012. Pet. App. 19a-26a.

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[7] Trial Exhibits ("Ex.") 7, 13, 15 and 22 indicate the location for each container redelivery.

[8] Stip. 1, 84; Pet. App. 27a, 35a. A sample transaction drawn from the audit period is illustrative. On March 5, 1985, the Shipping Company of New Zealand accepted possession of a 40′ Itel dry van container. The container was loaded onto the chassis of a common carrier hired by the steamship line, loaded with cargo and carried by rail to an international port. The container then traveled the globe until it was returned at Itel's San Francisco terminal on May 5, 1986. Because the lease term was 427 days and Itel charged $3.50 per day, the steamship line paid $1,494.50 for the use of the container from the first importation to the return of the container in San Francisco. Tennessee's sales tax totaled 5.5% of the gross proceeds, or $82.20. Ex. 7, 13, 15.

[9] Petitioner already was paying sales and use taxes on fees collected in connection with repair services performed at its Memphis terminal. Stip. 38, Pet. App. 31a. Those taxes are not at issue here.

The Opinion Below. The Tennessee Supreme Court affirmed. Pet. App. 1a-8a. It recognized this Court's holding in *Japan Line* that a state ad valorem property tax on containers owned by foreign domiciliaries violates the Foreign Commerce Clause. The court also acknowledged that "Itel's containers, like Japan Line's containers, are instrumentalities of foreign commerce" (*id.* at 7a), and it expressly declined to distinguish *Japan Line* on the ground that in this case the tax happens to fall on a domestic domiciliary. *Id.* at 7a-8a. Instead, the court found a constitutional distinction between sales and property taxes (see *id.* at 12a), holding that state sales taxes by their very nature satisfy the requirements of the Foreign Commerce Clause because they pose no risk of multiple taxation (*id.* at 14a-15a) and cannot interfere with the federal government's management of foreign relations or international trade. *Id.* at 15a-16a.

The court next held that the Tennessee tax was not preempted by the Container Conventions and the Treasury Department's implementing regulations. It distinguished this Court's decisions in *Xerox Corp. v. Harris County*, 459 U.S. 145 (1982), and *McGoldrick v. Gulf Oil Corp.*, 309 U.S. 414 (1940) (which held state property and sales taxes preempted by federal statutes that exempted goods from Customs duties when stored under bond in designated warehouses), finding that federal regulation of Customs bonded containers is "less pervasive" than the regulation of Customs bonded warehouses. Pet. App. 14a. The court also reasoned that preemption is inappropriate because the Container Conventions were not intended to benefit container owners. *Id.* at 10a.

Finally, the court turned aside Itel's claim under the Import-Export Clause. In rejecting the argument that the Tennessee tax is invalid under *Richfield Oil Corp. v. State Board of Equalization*, 329 U.S. 69 (1946), the court below evidently concluded that *Richfield's* holding did not survive this Court's more recent decisions in

Michelin Tire Corp. v. Wages, 423 U.S. 276 (1976), and *Department of Revenue v. Ass'n of Washington Stevedoring Cos.*, 435 U.S. 734 (1978). See Pet. App. 16a-17a. And in applying the Import-Export Clause test set out in *Michelin*, the court again found it dispositive that the tax at issue here is one on sales rather than on property. *Id.* at 18a.

SUMMARY OF ARGUMENT

I. Tennessee's sales tax imposed on container leases is repugnant to both the letter and the spirit of the Container Conventions, treaties between the United States and 58 other nations. The Conventions expressly prohibit the imposition of taxes collected "by reason of" or "in connexion with" the importation of containers. The 1972 Convention allows the signatory nations to impose only taxes "limited to the approximate cost of services rendered." Tennessee's sales tax is levied "by reason of" or "in connexion with" the importation of containers; the containers would not be subject to taxation but for their importation into Tennessee, and the tax is assessed upon the entire value of container leases throughout a continuous series of import/export shipments. This reading of the Conventions is confirmed not only by their plain language, but also by the uniform custom of the signatory nations.

Aside from the Conventions' express prohibition, Tennessee's sales tax is preempted because it undermines the principal objectives of the Conventions and the federal regulatory scheme. The impact of Tennessee's tax is substantial enough to erase the very benefit provided by Congress—the waiver of Customs duties. And by substantially increasing the cost of container transport, the tax discourages container use in foreign commerce, places American container owners at a competitive disadvantage, and stunts American export trade—the precise objectives the United States seeks to promote. It is manifest that Tennessee's tax is preempted by the force of

this Court's reasoning in *McGoldrick v. Gulf Oil Corp.*, 309 U.S. 414 (1940), and *Xerox Corp. v. Harris County*, 459 U.S. 145 (1982).

II. In addition, like the California property tax at issue in *Japan Line*, Tennessee's sales tax violates the Foreign Commerce Clause because it creates an unacceptable risk of international multiple taxation and prevents the United States from speaking with one voice with respect to its foreign trade. Tennessee's tax on the full value of container leases invites multiple international burdens; many foreign nations have a sufficient taxable nexus to impose equivalent taxes upon the lease proceeds —and would, in fact, impose such taxes were it not for the prohibitions of the Container Conventions. The Tennessee sales tax, moreover, whether imposed on foreign container lessors or lessees, will inevitably lead to foreign retaliation felt not just by Tennessee, but by the United States as a whole. Such retaliation already has been at least implicitly threatened. And the United States, of course, cannot "speak with one voice" with respect to foreign trade if Tennessee and other States subject containers to "various degrees of multiple taxation, depending on which American ports they enter." *Japan Line*, 441 U.S. at 453.

III. Finally, Tennessee's direct tax on "in-transit" containers violates the Import-Export Clause—not only because it prevents the Federal Government from speaking with one voice, but because it is "no more than [a] transit fee[] on the privilege of moving through a State." *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 290 (1976). The Court has never construed the Clause to permit the type of tax imposed by Tennessee. Under both the Court's modern analysis and the Court's holding in *Richfield Oil Corp. v. State Board of Equalization*, 329 U.S. 69 (1946), which is indistinguishable from this case, a state sales tax on an in-transit export or import violates the Import-Export Clause.

ARGUMENT

I. THE TERMS AND OBJECTIVES OF THE CONTAINER CONVENTIONS PREEMPT THE IMPOSITION OF TENNESSEE'S SALES TAX

State regulations that "actually conflict[] with federal law" must fall. *Fidelity Federal Savings & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 153 (1982). Tennessee's tax—which is "collected on, or in connexion with, the importation of goods" [10]—is preempted because it is flatly inconsistent with the plain terms of the Container Conventions. In fact, Tennessee's application of its sales tax to the leasing of containers engaged in foreign commerce is a remarkable departure from what has been universal practice under the Conventions. For the 36 years that one or the other of the Conventions has been in effect, so far as we have been able to determine, *not one* of the 59 signatories or their innumerable political subdivisions has imposed such a tax. But even without regard to the clear language of and consistent practice under the Conventions, Tennessee's tax is preempted because it "offset[s] substantially the very benefits Congress intended to confer" by excepting cargo containers from customs duties. *Xerox Corp. v. Harris County*, 459 U.S. 145, 153 (1982).

A. The Tennessee Tax Cannot Be Reconciled With The Language Of The Conventions

When interpreting a treaty, this Court begins "with the text of the treaty and the context in which the written words are used." *Air France v. Saks*, 470 U.S. 392, 397 (1985). Here, the 1956 Convention provides for the temporary admission of containers free of import duties and taxes, which are defined as "not only Customs duties but also *all duties and taxes whatsoever* chargeable by reason of importation." 20 U.S.T. at 304 (emphasis added). The 1972 Convention offers a similar but broader

[10] 1972 Convention, Art. 1(b), 988 U.N.T.S. at 44. The prohibition expressed in the 1956 Convention is similar, prohibiting all "taxes whatsoever chargeable by reason of importation." Art. 1(a), 20 U.S.T. at 304.

description of the proscribed taxes, prohibiting the imposition of "Customs duties *and all other duties, taxes, fees and other charges* which are collected on, or in connexion with, the importation of goods." 988 U.N.T.S. at 44 (emphasis added). The 1956 Convention ensures a broad interpretation of the prohibition by modifying "all * * * taxes" with the adjective "whatsoever." The 1972 Convention also proscribes "all" taxes and then makes the prohibition as inclusive as possible by the reference to "fees and other charges."

The Container Conventions do not except taxes imposed by subnational units, such as States. To the contrary, "all * * * taxes" are prohibited. The breadth of the prohibition is magnified by the 1972 Convention's sole, narrow exception of "fees and charges limited in amount to the approximate cost of services rendered" (988 U.N.T.S. at 44), an exception that has no bearing here. If the parties to the 1972 Convention intended to allow sales or transaction taxes on container transfers, they could easily have expanded the exception clause.

Tennessee's sales tax is "chargeable by reason of importation" and collected "in connexion with the importation of goods." The texts of the Conventions recognize that the concept of importation describes the continuous status of a container while present in a signatory nation, not a discrete event temporally related to the crossing of a border. Article 3 of the 1956 Convention describes containers as "temporarily imported" when they are within national borders. Article 1(b) of the 1972 Convention similarly describes the containers as subject to "temporary importation." Under the fiction of "temporary admission," the containers remain temporarily imported throughout their stay in the United States. Thus, when Tennessee's tax was imposed, Itel's containers were temporarily imported goods.[11] Further, the tax here—which attaches only when containers physically are transferred

[11] The containers' status as temporarily imported goods is not changed upon leasing for re-export from the United States.

in Tennessee—is triggered in a direct sense by the entry of goods into the taxing jurisdiction; it is the containers' visit to Tennessee that (in part) is responsible for the tax. And a tax that is assessed only because the taxed good entered into the taxing jurisdiction surely is one that is imposed "by reason of" or "in connexion with" importation.

In addition, because Tennessee makes no effort to apportion its sales tax to the fraction of the lease term during which a container is present in Tennessee or the distance traveled by the container—and because all of Itel's leases culminated with an importation to a Container signatory nation—its sales tax necessarily is imposed "by reason of" or "in connexion with" one or more importations. Ex. 7, 13, 15, 22. Thus, Tennessee's tax was imposed upon the time-value of "temporarily imported" containers throughout the term of each lease.

Indeed, the court below sensibly did not take issue with the proposition that Tennessee's sales tax on containers is one imposed "by reason of" or "in connexion with" the importation of the containers. Instead, the court avoided a finding of preemption only by pointedly ignoring the Conventions' language, which the court nowhere so much as mentioned. But when the language *is* considered, it seems self-evident that the levy—which undoubtedly is a "tax" within the meaning of both Conventions—must be preempted.[12]

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[12] Although we find the Conventions unambiguous on this point, it is worth adding that any doubt should be resolved in favor of preemption. *Cf. Air France*, 470 U.S. at 396 (treaties "are construed more liberally than private agreements"). Treaties must be construed to effectuate the intent of the signatories—signatories that are not concerned with respecting principles of American federalism. In contrast, preemption is disfavored in cases involving federal statutes because Congress is presumed not to have sought to displace state law. Consequently, as the Court has noted in finding a state tax preempted by a treaty: "When a treaty provision fairly admits of two constructions, one restricting, the other enlarging rights which may be claimed under it, the more liberal interpretation is to be preferred. [Citations omitted.] And as the treaty-making power is independent of and superior to the legislative power of the States, the meaning of treaty provisions so construed is not restricted by any necessity of avoiding possible conflict with State legislation, and when so ascertained must prevail over inconsistent State enactments." *Nielsen v. Johnson*, 279 U.S. 47, 51-52 (1929).

The "actual, reasonably harmonious practice adopted by the United States and other signatories" to the Conventions confirms this interpretation. *Trans World Airlines, Inc. v. Franklin Mint Corp.*, 466 U.S. 243, 259 (1984). *None* of the 59 signatories—or their subnational units, with the sole exception of Tennessee—has sought to tax the transfer of containers. To the contrary, those nations and their political subdivisions, including the principal trading nations of the European Community and Japan, have affirmatively exempted from their sales and use tax equivalents all transactions involving containers that are engaged in international commerce.[13]

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[13] The member countries of the European Community, for example, have adopted a suggested uniform system of value added taxation that imposes "output" and "input" taxes, which are collected in a manner similar to sales and use taxes. O.J. European Comm. (No. L 145) arts. 2, 6 (1977) (Sixth Directive 77/388). *Cf. Trinova Corp. v. Michigan Department of Treasury*, 111 S. Ct. 818, 825 n.3 (1991). The leasing of goods is considered a taxable supply of services. See Sixth Directive art. 6. The Community nevertheless honors its member countries' obligations under the Conventions by exempting from value added taxation (1) imported goods that qualify for Customs duty exemptions and (2) supplies of services that are directly linked to the transit or export of goods. *Id.* arts. 14(I)(c), 15(1). See United Kingdom Br. 7-8 & n.14 (explaining operation of and exemptions to VAT). Similarly, Japan grants an exemption under its consumption tax to rents from the lease of containers that are used in international commerce. Consumption Tax Law, art. 17(2)(ii). Eleven of our principal trading partners have lodged a diplomatic note with the State Department protesting the Tennessee tax and representing that, "[c]onsistent with obligations under the Conventions, neither the Governments [signatory to the note] nor any political subdivisions impose sales taxes (or equivalent taxes of different nomenclatures) on the lease of cargo containers that are used in international commerce among the Contracting Parties to the Conventions." (A copy of the note is appended to the brief filed by the United Kingdom in this case.)

This uniform practice cuts powerfully in favor of preemption here. *Cf. O'Connor v. United States*, 479 U.S. 27, 33 (1986); *Air France*, 470 U.S. at 403; *Trans World Airlines*, 466 U.S. at 260.

Indeed, we have more in this case than the implicit endorsement of our reading that may be derived from the custom of nations. Eleven of our most significant trading partners have lodged a note with the State Department explaining their "view that the application of Tennessee's sales tax to leases of international-commerce cargo containers is in direct contravention of the Government of the United States' undertakings in these Conventions." (A copy of the note is appended in the brief filed in this case by the United Kingdom.) And the United Kingdom, a signatory to the 1956 Convention and one of the world's leading maritime nations, has informed the Court expressly that

> International-commerce containers leased while in Tennessee are there precisely "by reason of importation," having entered the U.S. in the course of their continuous use in the cross-border commerce that the Convention is designed to facilitate. The presence of a marine container, for example, in Tennessee is due to its "temporary admission" into the United States under Article 3 of the Convention, which allows entry of a container into the territory of a Contracting Party for only a limited time (up to three months) before it once again embarks on a journey on the high seas *en route* to the territory of another Contracting Party. In other words, the container is in Tennessee only by reason of the fact that it has been imported as an international-commerce container, *i.e.*, "by reason of importation."

Br. of the United Kingdom ("U.K.") 7. In these circumstances, it would be "particularly inappropriate for a court to sanction a deviation from the clear import of a solemn treaty between this Nation and * * * foreign sovereign[s], when, as here, there is no indication that

application of the words of the treaty according to their obvious meaning effects a result inconsistent with the intent or expectations of its signatories." *Maximov v. United States*, 373 U.S. 49, 54 (1963).

B. The Executive Branch and Congress Intended to Preempt State Regulation of Federally Bonded Containers Used Exclusively in Foreign Commerce

1. *The Tax Is Inconsistent With The Objectives of the Container Conventions*

Tennessee's tax is not invalid only because of the express language of the Conventions. It is equally preempted if, "under the circumstances of this particular case, [the tax] stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" and the Executive Branch. *Hines v. Davidovitz*, 312 U.S. 52, 67-68 (1941). Tennessee's tax presents such an obstacle.

The "container revolution" was driven by tremendous savings in labor costs due to the elimination of intermediate loading and unloading of cargo. Nevertheless, transporting goods by container carried its own unique disadvantage. The reusable metal containers are themselves valuable articles that were subject to duties and taxes imposed as they travelled the oceans and continents—levies that would add to the cost, and thus discourage the use, of container transport.

The signatories to the 1956 Container Convention desired generally to "develop and facilitate the use of containers in international traffic" by addressing this very problem. The Convention accomplishes this goal by reducing the cost of container use through the broad prohibition of duties and taxes. In recommending that the Senate consent to the United States' accession to the treaty, President Lyndon Johnson recognized that the protections provided by the 1956 Convention not only

aided container transport generally but also were "of special importance to those Americans engaged in business in foreign countries" and would "aid the American export drive." President's Letter of Transmittal, 1956 Customs Convention on Containers, 89th Cong., 2d Sess. (June 30, 1966), *reprinted in* 108 Journal of the Executive Proceedings of the Senate, Pt. 1 at 668, 669 (1966). The Senate thus consented to this country's accession to the 1956 Convention both to "simplify[] and facilitat[e] the movement of goods in international trade" generally and to provide "direct benefit to American business interests in the territories of other parties to the convention[]." S. Rep. No. 1618, 90th Cong., 2d Sess. 2 (1968). After its ratification, the 1956 Convention was implemented in the United States by Treasury Department regulations designating containers "instruments of international traffic" (19 C.F.R. 10.41a(a)(1)) and by a statute excepting such instruments from application of the Customs laws. 19 U.S.C. 1322(a).

Pointing to this regime, the United States explained to this Court in *Japan Line* that "[a] state tax [on containers] would frustrate accomplishment of the federal objective" (No. 77-1378, U.S. Br. 28) and therefore "conflict[] with the spirit and design of the federal scheme." *Id.* at 29 (footnote omitted). The Court agreed, quoting from the 1956 Convention's provision prohibiting import duties and taxes and concluding that the "Convention reflects a national policy to remove impediments to the use of containers as 'instruments of international traffic.'" *Japan Line*, 441 U.S. at 453. The Court, utilizing "a species of pre-emption analysis" (*Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 194 (1983)), reasoned that California's property tax on containers placed "impediments before this Nation's conduct of its foreign relations and its foreign trade." *Japan Line*, 441 U.S. at 453.

Since that time, the international proscription on local regulation of containers has become considerably *stricter*

with ratification of the 1972 Container Convention. Adoption of the 1972 Convention was prompted by "the considerable increase in numbers of containers used in international traffic" and the "need both for simplifying Customs formalities and facilitating container transport." U.N. Doc. E/CONF. 59/2 (Feb. 22, 1971), at 1 (Note by the Secretariat). As the United States noted in its comment on the draft 1972 Convention, the revision of the 1956 treaty was designed to "contribute significant economic benefits to the development and facilitation of international container traffic on a global basis." U.N. Doc. E/CONF. 59/16 (Nov. 26, 1971), at 2.[14] The preamble to the 1972 Convention thus affirms the treaty's purpose "to develop and facilitate international carriage by container" (988 U.N.T.S. 43, 44), which it accomplishes, in part, through its prohibition of "Customs duties and all other duties, taxes, fees and other charges" on containers. *Ibid.*

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[14] The United States further explained that its "role in the evolution of the container system" is "dedicated largely to eliminating the artificial barriers which the division of the world into nation States poses for efficient movement and trade." U.N. Doc. E/CONF.59/IPG.2, Annex at 14 (Feb. 14-18, 1972). With regard to the contemporaneously-drafted International Convention for Safe Containers, Dec. 2, 1972, [1979] (39 U.S.T. 3707), which establishes safety standards for containers, the United States similarly commented that "[a] plethora of dissimilar national regulations would work great hardship upon the international system and would be at variance with the objective of facilitating container traffic on a global basis." U.N. Doc. E/CONF.59/IPG.2 at 15 (Feb. 14-18, 1972). With respect to the proposed draft convention on the International Combined Transport of Goods, the United States expressed related goals: "The United States Government strongly supports the further development of containerization which promises so much in reducing unit transport cost. * * * It sees containerization as having a profound effect in the transport system through the technology and possibilities for efficiency inherent in it. Consequently, it maintains that the legal and documentary regime governing the use of this transport should be as forward-looking as the technology." U.N. Doc. E/CONF.59/24 at 3 (June 23, 1972).

The United States entered into the 1972 Convention, as it had the 1956 Convention, both generally to encourage the use of containers and specifically to promote the interests of American container owners. The Department of State and the Senate both concluded not only that the 1972 Convention "should contribute significantly to the development of international container traffic on a global basis," but also that "[a] primary effect of the Convention will be to facilitate the use of United States-owned and operated containers in international traffic by ensuring that they receive treatment in the territories of the Parties to the Convention similar to that which is afforded to foreign-owned containers in the United States at the present time." Message from the President of the United States Transmitting the Customs Convention on Containers, 1972, and the International Convention for Safe Containers, both signed at Geneva on Dec. 5, 1972, Exec. X, 93d Cong., 1st Sess. vi (1973); Exec. Rep. No. 94-33, at 1.

Against this background, it is manifest that the imposition of a tax on the transfer of containers would frustrate federal policy in the most direct imaginable manner: it would add expense to a transaction that Congress intended to be cost-free—and it would substantially reduce the very benefit that Congress intended to confer by exempting containers from *federal* Customs duties. The magnitude of this effect may be demonstrated on the record here. During the tax audit period, reusable cargo containers of the kind leased by Itel were subject to Customs duty unless otherwise exempted. General Headnotes 6(a) and (b)(ii) to the Tariff Schedules of the United States (TSUS). Ad valorem Customs duties during the audit period ranged from 2.5% to 0.6%. TSUS 640.30. Because the replacement value of the containers leased during the audit period was $11,189,172, the Customs exemption benefited Itel by some $178,550.[15]

[15] The Tennessee Department of Revenue audited the delivery of Itel's containers in Tennessee from January 1, 1983 through November 30, 1986, examining lease transaction data from two one-month test periods (Feb. 15-Mar. 14, 1985 and Mar. 1986). Itel transferred possession of 122 containers in Tennessee during the two test months. The container leases establish replacement values ranging from $2,875 to $6,560 for each container. The United States Customs Service calculates the dutiable "transaction value" of imported leased goods by determining the consideration that would be paid to purchase identical goods. 19 C.F.R. 152.101(b). By projecting the number and replacement value of the containers leased during the test months for the full 47-month audit period, and by applying the prevailing duty rates during each calendar year (2.5%, 1.9%, 1.3% and 0.6%, respectively), the duties may be estimated. See TSUS 640.30; Tr. 33; Ex. 7, 13, 15, 22.

By comparison, Tennessee's revised sales tax assessment was $158,012, which nearly erased the benefit provided by the Customs duty exemption. This charge on the transfer of containers that have entered Tennessee surely is an "impediment[] to the use of containers" in international traffic. *Japan Line*, 441 U.S. at 453, discourages the "use of American-owned containers" and frustrates the "American export drive."

2. McGoldrick *and* Xerox

In circumstances that are in all relevant respects identical to those here, this Court has invalidated state taxes that substantially reduce economic benefits provided by Congress. In *McGoldrick v. Gulf Oil Corp.*, 309 U.S. 414 (1940), and *Xerox Corp. v. Harris County*, 459 U.S. 145 (1982), the Court held state sales and property taxes on Customs bonded goods preempted by the federal Customs bonded warehouse statutes. The federal statutes at issue in those cases excepted the bonded goods only from Customs duties; the state sales and property taxes at issue were not expressly prohibited.[16]

[16] The *McGoldrick* Court did not rely upon Art. 942 of the Customs regulations that exempted bonded warehouse goods from state taxation, stating that the regulations expressed "only what is implicit in the congressional regulation of commerce." 309 U.S. at 429. The Treasury Department later deleted the regulation exempting State taxation, effective December 1, 1982. The deletion of the regulation

The *McGoldrick* and *Xerox* Courts examined the federal objectives promoted by the Customs duty exemptions to determine whether the state taxes were inconsistent with them. The purpose of the exemption in *McGoldrick* was to remedy a competitive disadvantage experienced by American fuel oil manufacturers caused by a federal duty upon the importation of crude petroleum. See 309 U.S. at 427. The bonded warehouse statutes considered in *Xerox* were enacted "to encourage merchants here and abroad to make use of American ports" and "to stimulate business for American industry and work for Americans." 459 U.S. at 151. Exempting bonded goods from import duties, the Court found, encourages those engaged in foreign trade to transship goods through American ports and stimulates the shipbuilding industry. See 459 U.S. at 150-151.

In both cases, the Court found the imposition of state taxes on the bonded goods to be incompatible with the policies underlying the Customs duty exemptions granted by Congress. The *McGoldrick* Court concluded that the imposition of a local sales tax upon the transfer of possession of fuel oil would frustrate the objectives of the federal regulation exempting the fuel from Customs duties:

> It is evident that the purpose of the Congressional regulation of the commerce would fail if the state were free at any stage of the transaction to impose a tax which would lessen the competitive advantage conferred on the importer by Congress, and which might equal or exceed the remitted import duty.

309 U.S. at 429. The *Xerox* Court followed *McGoldrick*, concluding that the state tax was large enough "to offset substantially the very benefits Congress intended to confer by remitting the duty." 459 U.S. at 153.

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did not alter the *Xerox* Court's conclusion "that the ad valorem taxes [were] preempted by the statutory scheme." 459 U.S. at 152 n.8.

The common thread in *McGoldrick* and *Xerox* is that the imposition of each state tax substantially reduced the benefit provided to goods dedicated to foreign commerce. In analyzing these cases, the Court noted that "[t]he difference in the types of taxes in the two cases was of no importance, for imposition of either [a sales or a property] tax would detract from the benefit accruing to the importer from the waiver of the duty." *R.J. Reynolds Tobacco Co. v. Durham County*, 479 U.S. 130, 143 n.10 (1986). In other words, "[b]ecause the [federal government's] waiver of import duties [in *Xerox*] so clearly furthered the Act's purposes, any attempt to remove its benefit, such as would occur through State taxation, was incompatible with these goals." *Id.* at 143.

McGoldrick and *Xerox* compel a finding of preemption here. The primary means selected by Congress to facilitate the use of containers is the waiver of Customs duties. Tennessee's sales tax of $158,012 upon Itel's container leases is "large enough * * * to offset substantially the very benefits Congress intended to confer" by relinquishing $178,550 in duties. *Xerox*, 459 U.S. at 153. Like the American fuel oil manufacturers in *McGoldrick* and the American shipbuilders in *Xerox*, the imposition of Tennessee's tax upon Itel, an American container leasing company, discourages the use of "United States-owned and operated containers." Because more than $84 billion in American exports are carried in containers annually, the routine application of state sales and use taxes to containers will frustrate "the American export drive."

More fundamentally, however, the frustration of federal policy is not limited to the Tennessee tax's effect on American industry. While the federal statutes in *McGoldrick* and *Xerox* benefited only American interests, the Container Conventions are designed generally to benefit all signatories by encouraging the use of containers internationally and thus lowering the cost of transporting cargo. This purpose of the Conventions would fail if Tennessee "were free at any stage of the transaction to

impose a tax which would lessen the * * * advantage conferred" by its provisions. *McGoldrick*, 309 U.S. at 429. Indeed, the United States' interest in the regulation of Customs-bonded containers is even more compelling than its concern with the regulation of imported crude oil in *McGoldrick* or the transshipment of copy machines in *Xerox*. That is because containers also are the subject of international treaties that prohibit local taxes, a factor not present in *McGoldrick* or *Xerox*. As the system of federal container regulation is just as pervasive as the bonded warehouse system examined in those cases, the United States regulatory scheme has left Tennessee no room to impose general sales taxes upon containers.

The court below offered two reasons for declining to follow *McGoldrick* and *Xerox*, which seem self-evidently controlling here. First, it found the decisions inapposite because, while the warehouse statutes were designed to benefit American shippers and ports, "the Court in *Japan Line* found no Congressional intent to benefit container companies in the statutes regulating cargo containers." Pet. App. 10a. But that reasoning involves an obvious *non sequitur*. Observing that the warehouse statutes and the Container Conventions serve different purposes (even if that observation is correct) has nothing to do with the question whether the purposes served by *both* sets of provisions are defeated by state taxation.[17] And in fact, the federal policy underlying the Container Conventions that was identified by the Court in *Japan Line—general* facili-

[17] In fact, the court below was incorrect if it meant to suggest that American participation in the Conventions was not designed to benefit American container operators. As explained above, *supra*, at 17-18, President Johnson, in his message to the Senate, noted that the 1956 Convention was "of special importance to those Americans engaged in business in foreign countries" and would "aid the American export drive." President Nixon later explained that the "[1972] Convention is important because it will insure United States-owned containers the same treatment in the territories of States parties to this Convention as that afforded in the United States to foreign-owned containers." Exec. X, 93d Cong., 1st Sess. iii (1973).

tation of the use of containers—is frustrated by a state tax in precisely the same way as were the federal goals at issue in *McGoldrick* and *Xerox*.

The Tennessee court also found preemption inappropriate because, in its view, "Congress' regulation of cargo containers is less pervasive than its regulation of bonded warehouses." Pet. App. 14a. In fact, the court was simply wrong in this; the relevant regulations (which were not so much as cited by the court below) and the Conventions themselves (whose terms were wholly ignored by the court) impose elaborate requirements relating to the admission, operation, and design of containers that parallel those imposed on Customs warehouses.[18]

[18] See 1972 Convention art. 3-8, 988 U.N.T.S. 45-46 (temporary admissions facilities and procedures); art. 9, *id.* at 46 (conditions on use of containers granted temporary admission); art. 10-11, *ibid.* (admission of parts and accessories); art. 12, *id.* at 47 (approval of containers used to transport goods under Customs seal); Annex 1, *id.* at 51-52 (identification and marking of containers); Annex 2, *id.* at 52 (obligation of container owners to provide detailed records concerning movement of temporarily admitted containers and to pay duties when condition of admission not satisfied); Annex 3, *id.* at 52 (use of containers in internal traffic); Annex 4, *id.* at 52-61 (technical conditions on design and structure of containers); Annex 5, *id.* at 61-67 (procedures for approval of containers). Federal regulations adopted under the authority of 19 U.S.C. 1322 and 19 U.S.C. 66 serve to comprehensively implement the directives of the Conventions: 19 C.F.R. 10.41a (excepting containers from the requirement of entry and payment of duties); 19 C.F.R. 113.66(a) (bond conditions); 19 C.F.R. Pt. 115 (procedures for approval and certification of containers). These regulations require that containers certified for transport under Customs seal meet the stringent design and construction requirements provided by the Container Conventions. Containers must be used solely in international commerce to qualify as "instruments of international traffic." In the event that a container is damaged, regulations detail the conditions under which it may be repaired or destroyed without the imposition of duties. Container owners must execute a special bond before release of containers into the United States. If a container is diverted to intrastate or interstate commerce, regulations provide for the payment of duties and liquidated damages. Neither the federal

More fundamentally, the state court's observation about the pervasiveness of federal regulation also is beside the point. Whether or not the container regulations are as detailed as those governing Customs bonded warehouses, the crucial factor here is that the Tennessee tax frustrates federal policy. Cf. *R.J. Reynolds Tobacco*, 479 U.S. at 148-149. *McGoldrick* and *Xerox* make clear that preemption is required in such circumstances.[19] Again, the United States took the position in *Japan Line* that the bonded warehouse provisions are "analogous" to the 1956

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implementing statute nor the regulations allow local taxation of containers.

While it is true that goods in Customs warehouses are held under the supervision and control of Customs officers (see 19 C.F.R. 19.4; *Xerox*, 459 U.S. at 147-148 & n.2) while containers are not, that is wholly a function of the practicalities of container operation; containers, of course, must remain in continuous movement along with the goods they transport. That does not detract either from the pervasiveness of the container regulations or from the force of the policies underlying those regulations. Indeed, while Customs officers cannot accompany every container on every journey, the 1972 Convention takes the next best step by providing that "the owner or operator [of the container] * * * will undertake in writing * * * to supply the Customs authorities, * * * at their request, detailed information concerning the movements of each container granted temporary admission including the dates and places of entry into and exit from [the] country." Annex 2(2)(b)(i), 988 U.N.T.S. at 52.

[19] The court below also seemed to suggest that preemption is inappropriate because 19 U.S.C. 1322(a) excepts instrumentalities of foreign commerce only from the Customs laws; the court concluded that "[t]he regulations adopted pursuant to that statute, therefore, can go no further than to provide exceptions from federal customs duties." Pet. App. 13a; see *id.* at 9a. In fact, however, the Conventions *themselves*, which of course have the force of federal law, expressly preclude taxes in addition to Customs duties. In any event, the state court's observation hardly serves to distinguish *McGoldrick* and *Xerox*, which found preemptive force in statutes that in terms addressed only Customs duties. And the property tax disapproved in *Japan Line* as inconsistent with the 1956 Container Convention was no more a Customs duty than is the sales tax at issue here.

Convention (No. 77-1378, U.S. Br. at 25), concluding that "[t]he rationale of *McGoldrick* applies here as well." *Id.* at 27 (footnote omitted). That reasoning was correct, and preemption accordingly is warranted in this case.

II. APPLICATION OF STATE SALES TAXES TO CONTAINERS USED EXCLUSIVELY IN FOREIGN COMMERCE VIOLATES THE FOREIGN COMMERCE CLAUSE

Japan Line. The decision that established the prevailing test for examination of state taxes on foreign commerce, *Japan Line*, providentially considered taxation of containers subject to the 1956 Container Convention. The *Japan Line* Court invalidated California's property tax on Japanese-owned containers used exclusively in foreign commerce. 441 U.S. at 437. Because taxation of foreign commerce creates an "enhanced risk of multiple taxation" and "may impair federal uniformity in an area where federal uniformity is essential," the Court concluded that such taxes must be scrutinized more closely than those on interstate commerce.[20] *Id.* at 446, 448. If a state tax either "creates a substantial risk of international multiple taxation" or "prevents the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments,'" the tax violates the Foreign Commerce Clause. *Id.* at 451.

California's property tax failed both prongs of the test. Since Japan collected a property tax on the full value of the containers, California's apportioned tax inevitably resulted in multiple taxation. *Id.* at 451-452. California's tax also prevented the United States from "speaking with one voice" in regulating foreign trade:

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[20] The tax must first satisfy the four-part test enunciated in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), for taxation of interstate commerce.

> The desirability of uniform treatment of containers used exclusively in foreign commerce is evidenced by the Customs Convention on Containers, which the United States and Japan have signed. [citation omitted]. Under this Convention, containers temporarily imported are admitted free of "all duties and taxes whatsoever chargeable by reason of importation." 20 U.S.T., at 304. The Convention reflects a national policy to remove impediments to the use of containers as "instruments of international traffic." 19 U.S.C. § 1322(a).

Id. at 452-453. The Court swiftly concluded that California's tax would "frustrate attainment of federal uniformity" because the risk of Japanese retaliation against American-owned containers was acute. *Ibid.* Moreover, if other States followed California's example, "foreign-owned containers [would] be subjected to various degrees of multiple taxation, depending on which American ports they enter," preventing the United States from "speaking with one voice" in international trade. *Ibid.*

The kinship between this case and *Japan Line* is striking. The articles taxed are identical. The containers were used exclusively in foreign commerce and regulated by one or both of the Container Conventions, 19 U.S.C. § 1322(a) and 19 C.F.R. § 10.41a. Federal Customs bonds secured the containers from diversion to domestic commerce. The containers were in constant transit save for time spent undergoing repair or awaiting loading and unloading of cargo. The containers engaged in no intrastate or interstate transportation of cargo except as continuations of international voyages. Any movements or periods of nonmovement of containers in the taxing jurisdiction were essential to, and inseparable from, the containers' efficient use as instrumentalities of foreign commerce. 441 U.S. at 436-37; Stip. 2, 21, 76, 77, 79, 82; Pet. App. 27a, 35a.

In nevertheless distinguishing *Japan Line*—which it evidently recognized otherwise would be controlling—the

Tennessee court found a difference of constitutional dimension between California's property tax and Tennessee's sales tax. See Pet. App. 16a. The court explained that "the transfer of possession of cargo containers is a discrete transaction, occurring only within Tennessee, which creates no risk of multiple international taxation." *Id.* at 14a (footnote omitted). As for the other concerns identified in *Japan Line*, the court similarly reasoned that none "are implicated by a sales tax on a discrete transaction occurring only in one jurisdiction." *Id.* at 16a. These conclusions, however, were far too facile: the Tennessee tax raises precisely the dangers to foreign commerce and to this nation's international relations that were dispositive in *Japan Line*.

A. Tennessee's Sales Tax Creates a Substantial Risk of International Multiple Taxation

Tennessee's Tax Invites Multiple Taxation. At the outset, the court below was simply wrong in suggesting that, because the taxable event occurs only in one jurisdiction, duplicative taxation is impossible in the case of a transaction tax. Tennessee's sales tax is imposed on the "full value" of the proceeds from container leases. Because Tennessee's only nexus with the lease transactions is a naked transfer of possession, foreign nations may impose a tax on other incidents of the leases, such as their execution, that occur within their borders. Others might tax the use of containers within their jurisdiction.

The prospect of such taxes is hardly hypothetical. As might be expected, some of the 59 Convention signatories and their innumerable political subdivisions—which among them employ every imaginable type of taxation—impose use taxes on leased goods. Others, such as the members of the European Community, assess value added taxes on lessees who make productive use of leased property. Were containers used in international commerce not specifically excepted from application of these value added taxes (see page 15 & n.13, *supra*), a lessee obtain-

ing a container in Tennessee and transporting it to Europe accordingly would be liable to pay a value added tax on precisely the same base as that already subjected to tax in the State—the gross proceeds of the lease.[21] And the prospect that foreign taxes of this sort could be directed at values already taxed by Tennessee are greatly compounded by the reach of the state levy: once a container is transferred to the lessee in Tennessee, the State applies its tax to all amounts paid throughout the course of what may be a very long and indefinite lease period.

The imposition of such foreign levies based upon the execution of the lease or use of the container is indeed equivalent to Tennessee's sales tax.[22] All are imposed on

[21] The member countries of the European Community typically define a "taxable person" to include any company that exploits "tangible * * * property for the purpose of obtaining income therefrom on a continuing basis." O.J. European Comm. (No. L 145) Art. 4 (1977) (Sixth Directive 77/388). EC member nations clearly would have sufficient taxing nexus to impose a tax upon leased containers used within their borders since "the place where [taxable] transport services are supplied is the place where the transport takes place, having regard to the distances covered." *Id.* art. 9(2)(b). And each taxing jurisdiction applies the tax to "everything which constitutes the consideration which has been or is to be obtained by the supplier from the purchaser." *Id.* Art. 11(A)(1)(a). The United Kingdom offers an example of this effect, describing the operation of its tax statutes. See U.K. Br. 8.

[22] Tennessee itself recognizes the equivalence between its sales tax and compensating use taxes by providing a sales-tax offset for use taxes that are paid to other States when *interstate* commerce is involved. Tenn. Code Ann. 67-6-313(f) (1989), -507 (1990). While the Court has formally reserved in the interstate setting whether a State that imposes a compensating use tax is constitutionally compelled to provide a credit for sales tax paid elsewhere (see *Williams v. Vermont*, 472 U.S. 14, 23 n.7 (1985)), it seems plain that the taxes are equivalent. See *Henneford v. Silas Mason Co.*, 300 U.S. 577, 583-587 (1937); *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 31 (1988) (the "taxing scheme is fairly apportioned, for it provides a credit against its use tax for sales taxes that have been paid in other States"); *Goldberg v. Sweet*, 488 U.S. 252, 264 (1989) ("to the extent that other States' telecommunication taxes pose a

the full value of the same lease. And, as explained by the United Kingdom (Br. at 7-9), foreign nations have a sufficient taxable nexus to tax the lease proceeds. That the labels selected by Tennessee and foreign nations to characterize their taxes are different "does not permit [the] Court to forgo examination of the actual tax base * * *. 'A tax on sleeping measured by the number of pairs of shoes you have in your closet is a tax on shoes.'" *Trinova Corp. v. Michigan Dept. of Treasury*, 111 S. Ct. 818, 829 (1991) (citation omitted).

The risk that foreign nations will apply equivalent taxes to container leases is real. In the event that this Court rules that the imposition of the tax is not preempted by the Container Conventions, the remaining 44 States that impose a form of sales taxation will likely follow Tennessee's example. The other 58 signatory nations that have relinquished their right to collect revenues on containers will be encouraged to respond by taxing all container leases or singling out containers owned or leased by American companies. Because Tennessee's tax is based upon "full value," like Japan's tax in *Japan Line*, even if a foreign nation "should seek to tax the same instrumentality on an apportioned basis, multiple taxation inevitably results." *Japan Line*, 441 U.S. at 447.

In the face of this prospect of multiple taxation, the lower court's conclusion that "the transfer of possession of cargo containers in Tennessee is a discrete transaction, occurring only within Tennessee, which creates no risk of multiple international taxation," was based upon a plain misreading of this Court's decision in *Wardair Canada, Inc. v. Florida Dept. of Revenue*, 477 U.S. 1 (1986). The *Wardair* Court's conclusory remark dismissing the risk of multiple taxation arising from a sales tax on aviation fuel was based upon the taxpayer's concession

risk of multiple taxation, the credit provision contained in the Tax Act operates to avoid actual multiple taxation").

and unique circumstances concerning the product taxed. The *Wardair* court found that Article 24(a) of the Chicago Convention on International Civil Aviation prohibited States from taxing aviation fuel that is " 'on board an aircraft * * * on arrival * * * and retained on board on leaving' a contracting party; it does not prohibit taxation of fuel purchased in that country." *Id.* at 10. In addition, as the United States explained, aviation fuel is a product that is consumed during the journey to the next potential taxing jurisdiction. U.S. Br. in support of prob. jur., No. 84-902, at 31. Thus, fuel sold in Florida could not be subjected to a multiple tax burden upon arrival abroad.

Multiple Taxation of Foreign Commerce. Duplicative taxation invariably has been deemed fatal to state levies in the interstate context because, by making an interstate transaction more expensive than an equivalent one that is performed entirely within one State, such taxes "exert[] an inexorable hydraulic pressure on interstate businesses to ply their trade within" one State "rather than 'among the several States.' " *American Trucking Ass'ns v. Scheiner*, 483 U.S. 266, 286-287 (1987) (citation omitted). See, *e.g.*, *Japan Line*, 441 U.S. at 446, 447; *Evco v. Jones*, 409 U.S. 91, 94 (1972); *Standard Oil Co. v. Peck*, 342 U.S. 382, 384-385 (1952). That conclusion applies with greatly increased force in the setting of foreign commerce, where "[e]ven a slight overlapping of tax—a problem that might be deemed *de minimis* in a domestic context—assumes importance when sensitive matters of foreign relations and national sovereignty are concerned." *Japan Line*, 441 U.S. at 456.

The propriety of this understanding—that a state tax cannot survive when it is the cause of inevitable multiple taxation—is confirmed by the Court's decision in *Container Corp.* There, the Court upheld California's method of apportioning foreign source income to itself for purposes of its corporate income tax, rejecting the claim that the use by other nations of differing income allocation methods would lead to impermissible multiple taxation. But the Court added that, "[i]f California's method of formula apportionment 'inevitably' led to double taxation * * * that might be reason enough to render it suspect." 463 U.S. at 192-193. See *Japan Line*, 441 U.S. at 455 ("This case * * * involves no mere mathematical imprecision in apportionment; it involves a situation where true apportionment does not exist and cannot be policed by this Court at all"). Here, Tennessee seeks to tax the full value of container leases, rather than apportioning the value of the lease by time or distance. Accordingly, the fact of multiple taxation flows from the nature of Tennessee's tax, in contrast to the dilemma in *Container Corp.* of trading one allocation method that "sometimes results in double taxation" in favor of another that creates the same risk. 463 U.S. at 193.[23]

It is plain, moreover, that when duplicative taxation is present the state tax must yield to the one imposed by a foreign nation. Holding in *Japan Line* that even an apportioned state tax must fall when it leads to duplicative taxation of foreign commerce, the Court emphasized that a state levy "must be evaluated in the realistic framework of the custom of nations. Japan has the right and the power to tax [the taxpayers'] containers at their full value; nothing could prevent it from doing so." 441 U.S. at 454. Indeed, the impossibility of assuring foreign

[23] If that conclusion is not sufficient to invalidate the tax, the other factors also considered by the Court in *Container Corp.*—"the context in which the double taxation takes place and the alternatives reasonably available to the taxing state" (463 U.S. at 189)—also militate against the Tennessee tax's constitutionality. Tennessee may "entirely eliminate one important source of double taxation simply by adhering to one bright-line rule: do not [impose a sales or use] tax, to any extent whatsover, [on] cargo containers 'that are * * * used exclusively in international commerce * * *.' " *Id.* at 189-90, quoting *Japan Line*, 441 U.S. 444. To require Tennessee to adhere to this rule is "by no means unfair, because the rule [does] no more than reflect consistent international practice and express federal policy." *Id.* at 190.

compliance with our notions of tax equity requires that the state levy fall even when it is the foreign tax that is in some sense the more responsible for the duplicative taxation. "In interstate commerce, if the domiciliary State is 'to blame' for exacting an excessive tax, this Court is able to insist upon rationalization of the apportionment. * * * [H]owever, this Court is powerless to correct malapportionment of taxes imposed from abroad in foreign countries." *Ibid.*[24]

The "Risk" Test. Although the Court did not reach the question in *Japan Line* (see 441 U.S. at 452 n.17), it plainly should not matter to this analysis that Itel's lease transaction now faces the *risk*, rather than the *actuality*, of multiple taxation. In assessing claims of duplicative taxation in the interstate setting, the Court has regarded it as elementary that "the constitutionaliy of [one State's] tax should not depend on the vagaries of [another State's] tax policy." *Mobil Oil Co. v. Commissioner of Taxes*, 445 U.S. 425, 444 (1980). The reason for that is manifest: "The immunities implicit in the Commerce Clause and the potential taxing power of the State can hardly be made to depend, in the world of practical affairs, on the shifting incidence of the varying tax laws of the various States at a particular moment." *Freeman v. Hewit*, 329 U.S. 249, 256 (1946). See generally *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232, 242 (1987); *Armco Inc. v. Hardesty*, 467 U.S. 638, 644-645 (1984). That reasoning has greatly magnified force in the international context, where the laws of more than 50 nations and thousands of subnational units intersect.

[24] Here, of course, there is no sense in which Tennessee has the greater entitlement to impose its tax: value added taxes are regarded as entirely legitimate by "the custom of nations" and are, in fact, among the most widely used form of taxation in the world. Having said this, it of course bears emphasis that, apart from international obligations such as the Container Conventions, it is within the power of Congress either itself to impose duplicative taxes on foreign commerce or to authorize such taxes by the States. But unless it does so, the States must take the international regime of taxing authority as they find it, and must refrain from the imposition of duplicative taxes that will have a destructive effect on the conduct of international trade.

In fact, a test that turned on the presence of actual multiple taxation would be both unmanageable and wholly divorced from the purposes of the Commerce Clause. Having the validity of a tax depend upon whether the taxpayer *already had paid* a tax in another jurisdiction—a sort of "first-come, first-tax basis'" (I J. Hellerstein, *State Taxation*, § 4.6[1][b] at 119 (1983))—would simply be irrational; it would have taxing power turn on the order of particular transactions and the alacrity of the local taxing authorities. And in the setting of foreign commerce, a test that looked to whether other taxing jurisdictions *actually had tax laws on the books* that might be employed against the taxpayer would require United States courts to master the tax laws of many other jurisdictions, while inviting continuing disputes about the equivalence (and thus about the economic substance) of foreign taxes that are based on unfamiliar theories. Such a test also would be impossible to administer when the tax at issue involved a sale or lease of property that was to travel in foreign commerce to destinations (and taxing authorities) not yet identified. See generally *id.* at 117-120.

Indeed, a requirement of actual multiple taxation would have an especially perverse effect in this case. Other nations have specifically withheld exercise of their taxing authority against containers in deference to the Container Conventions, as part of an attempt to encourage unrestricted international trade. Having the forbearance of those nationse validate Tennessee's tax would be a peculiar irony that cannot be required by the policies underlying the Foreign Commerce Clause.

Discriminatory Scheme of Tax Credits. The harmful effects of the duplicative taxation threatened by the Ten-

nessee system is compounded by a related element of the state tax regime: it discriminates against foreign and in favor of interstate commerce. In *Japan Line*, California imposed a non-discriminatory apportioned tax that collided with Japan's right to tax the "full value" of the containers. Here, Tennessee has chosen to "prevent actual multi-state taxation" by providing a credit for compensating taxes "paid in another state" without providing a corresponding credit for taxes paid in a foreign nation. Tenn. Code Ann. 67-6-313(f). Thus, while the full value of intrastate and interstate container leases may be taxed only once, Tennessee does not even attempt to relieve container leases from multiple foreign tax burdens.

B. Tennessee's Tax Prevents the United States From Speaking With One Voice in Regulating Foreign Trade

While the prospect of duplicative taxation is enough to invalidate application of Tennessee's tax, the "one voice" test articulated in *Japan Line* provides an independent basis to scuttle the tax. The tax fails the "one voice" standard if it "*either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive." *Container Corp.*, 463 U.S. at 194. The Court has recognized that the second consideration is "essentially a species of pre-emption analysis." *Ibid.* For the reasons explained above, the collision between the purposes of the Container Conventions and Tennessee's tax makes clear that the levy cannot survive that inquiry. But the tax also must fall because it "implicates foreign policy issues which must be left to the Federal Government." *Ibid.*

Interference with Foreign Relations. In *Japan Line*, California's taxation of Japanese-owned containers implicated foreign policy issues because it created a risk of retaliatory taxes upon American-owned containers in Japan. *Japan Line*, 441 U.S. at 453. Like California's

property tax, Tennessee's sales tax on containers is "a novel state tax [that] creates an asymmetry in the international tax structure" (*id.* at 450)—a proposition that the Tennessee court did not dispute. Instead, the court asserted that the risk of foreign retaliation is not "implicated by a sales tax on a discrete transaction occurring only in one jurisdiction." Pet. App. 16a. This *ipse dixit* is insupportable.[25]

There is no reason to doubt that imposition of Tennessee's sales tax on containers owned by foreign container lessors will invite retaliation by other nations.[26] And the prospect that the Tennessee tax will irritate foreign interests is not limited just to its direct effects on foreign lessors. Although the legal incidence of Tennessee's sales tax falls upon Itel, a Delaware corporation headquartered in California, state law mandates that the tax be separately stated on the bill submitted to the lessee and requires that the tax "be collected by the retailer from the consumer insofar as it can be done." Tenn.

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[25] In *Wardair*, which involved a Florida sales tax similar to the one at issue here, Justice Blackmun, the only Member of the Court to reach the constitutional issue, flatly rejected reasoning of the sort relied upon by the state court here. As he explained, "[t]he tax imposed in this case by Florida * * * is indistinguishable, for Commerce Clause purposes, from the tax imposed by California on containers in *Japan Line*." 477 U.S. at 18 (Blackmun, J., dissenting). That was the case, he continued, because "other countries may react to Florida's tax with various retaliatory measures against United States carriers abroad, retaliation that 'of necessity would be felt by the Nation as a whole.'" *Id.* at 20, quoting *Japan Line*, 441 U.S. at 453. The Court held in *Wardair* that the Federal Government had affirmatively permitted application of the Florida tax, notwithstanding the levy's effects on foreign commerce. *See* 477 U.S. at 3-4, 9-10, 12. The Court expressly reserved the question discussed by Justice Blackmun, noting that "nothing in this opinion should be understood to address[] whether, in the absence of the international agreements [permitting state taxation], the Foreign Commerce Clause would invalidate Florida's tax." *Id.* at 13.

[26] The record establishes that at least one foreign container owner transfers containers to lessees in Tennessee. Tr. 89-90.

Code Ann. 67-6-502. This obligation to collect the tax from the lessee is mandatory. See *Hooten v. Carson*, 209 S.W.2d 273, 275 (Tenn. 1948). Indeed, a seller or lessor who fails to collect the tax at the time of the transaction may bring an action against the purchaser or lessee for the amount due or paid. See *Sam Carey Lumber Co. v. Sixty-One Cabinet Shop, Inc.*, 773 S.W.2d 252, 254-55 (Tenn. App. 1989).

Thus, the practical and legal burden of the tax falls in substantial part on Itel's lessees, 80% of which during the tax period were steamship lines domiciled in foreign countries. Tr. 31-33. Most of those nations have signed the Container Conventions (Tr. 30-31) and thus now refrain from collecting taxes on the transfer of containers. But if forced to pay the tax, Itel's foreign customers may well demand that their governments impose corresponding tax burdens on American shipping companies who lease containers overseas. "The risk of retaliation * * *, under these circumstances, is acute, and such retaliation of necessity would be felt by the Nation as a whole." 441 U.S. at 453. As in *Japan Line*, "[t]his result, obviously, would make 'speaking with one voice' impossible." *Ibid.*

The prospect of retaliation here, it should be emphasized, is not hypothetical. The United Kingdom, in its submission to this Court, has represented that "[i]f the United States were now to interpret the Convention other than in the manner in which it has been uniformly implemented for decades, the United Kingdom and other nations of similar persuasion are not likely to tolerate a situation in which they refrain from imposing taxes while U.S. political subdivisions impose theirs." U.K. Br. at 10-11. Not surprisingly, the Court has rejected the contention that a State is free to impose such "demonstrable burdens" on the commerce of the United States. *Japan Line*, 441 U.S. at 454.

The Need for a Uniform National Rule. The substantial likelihood that it will provoke retaliatory action by

other nations is not the only way in which the Tennessee tax "would make 'speaking with one voice' impossible." *Japan Line*, 441 U.S. at 453. The area of container taxation is one that, the United States and its trading partners have made clear through their actions, must be addressed at a national level. Yet, as in *Japan Line*, "[i]f other States follow [Tennessee's] example * * *, foreign-owned containers will be subjected to various degrees of multiple taxation, depending on which American ports they enter." *Id.* at 453. At the same time, Tennessee's tax, while of parochial benefit to that one State, will increase the price both of containers traveling through the United States and of the cargo exported in them. As the Court has suggested in a related setting, that will have "harmful effects on American industry and workers" by discouraging use of American ports and the consumption overseas of American goods. *R.J. Reynolds*, 479 U.S. at 145. The requirements of the Foreign Commerce Clause surely mean that Tennessee, "by its unilateral act, cannot be permitted to place these impediments before this Nation's conduct of its foreign relations and its foreign trade." *Japan Line*, 441 U.S. at 453.

Itel's Domestic Domicile. It is worth adding that, for present purposes, it is immaterial that Itel is a domestic domiciliary. The court below, of course, disclaimed reliance on that consideration. See Pet. App. 7a-8a. It may be that, in certain factual circumstances, a tax on domestic taxpayers will be less likely than one on foreign concerns to disturb international relations. Cf. *Container Corp.*, 463 U.S. at 195. But that is not the case here. The tax here *must* be passed on to Itel's customers, most of whom are foreigners who surely will complain to their governments. That is powerfully demonstrated by the support accorded Itel in this Court by associations both of domestic and foreign container lessors and lessees. See Br. of Asia North America Eastbound Rate Agree-

ment, *et al.*; Br. of Cronos Containers, *et al*; Br. of Pacific Merchant Shipping Ass'n, *et al.* And it is particularly telling that the United Kingdom has taken the unusual step of expressing its views to this Court—and that many of our trading partners have filed a diplomatic note challenging the Tennessee tax—in a case that does not involve one of their domiciliaries. As in *Japan Line*, the state tax thus plainly prevents the United States from speaking with one voice in regulating foreign trade.

III. TENNESSEE'S TAX VIOLATES THE IMPORT-EXPORT CLAUSE

A. The Purpose of the Clause

The Import-Export Clause provides that "No State shall, without the Consent of Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing its Inspection Laws." U.S. Const. Art. I, § 10, cl. 2. In *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976), the Court explained the purpose of the Clause: "In effect, the Clause was fashioned to prevent the imposition of exactions which were no more than transit fees on the privilege of moving through a State." *Id.* at 290 (citing *License Cases*, 5 How. 504, 575-576 (1847) (Taney, C.J.)). While the Court has explained that "the term 'Impost or Duty' is not self-defining and does not necessarily encompass all taxes" *Washington Revenue Dept. v. Association of Washington Stevedoring Cos.*, 435 U.S. 734, 759 (1978)), the Court has never construed the Clause to permit the type of state tax imposed by Tennessee—a direct tax on goods merely in transit through the State.

Indeed, it was commonly understood at the Constitutional Convention of 1787 that States were not to be permitted to place direct taxes on exports. During the debate on the last draft of the Tax Clause (Art. I, § 8, cl. 1), James Madison, contending that the Federal

Government should have the power to tax exports, argued that since "*the States cannot with propriety exercise it [the power of taxing exports] separately*, it ought to be vested in them collectively." 2 M. Farrand, *The Records of the Federal Convention of 1787*, p. 306 (1911) (emphasis added). Later, the predecessor to the Import-Export Clause was amended by "insert[ing] after the word 'imports' the words 'or exports' *so as to prohibit the States from taxing either.*" *Id.* at 442 (emphasis added).

By definition, cargo containers that are traveling in international commerce pursuant to the Conventions have characteristics both of imports and of exports; they have arrived in this country from overseas and will immediately leave as part of a continuous journey. The imposition of a tax on these containers, which are "instrumentalities of foreign commerce, both as a matter of fact and as a matter of law" (*Japan Line*, 441 U.S. at 445-46), cannot be reconciled with the Import-Export Clause.

B. The *Richfield* Decision

It is undeniable that the Tennessee tax is unconstitutional under the principles announced in this Court's earlier holdings applying the Clause, where "the dispositive question was whether the goods had entered the 'export stream,' the final, continuous journey out of the country." *Washington Stevedoring*, 435 U.S. at 752. The Court thus held in *Richfield Oil Corp. v. State Board of Equalization*, 329 U.S. 69 (1946) that California's sales tax imposed on a shipment of oil bound for New Zealand violated the Import-Export Clause. Like the tax here, the state tax invalidated in *Richfield* was a generally-applicable sales tax levied on sellers "[f]or the privilege of selling tangible personal property at retail," who in turn were "authorized to collect the tax from the consumers." 329 U.S. at 83. The *Richfield* Court dismissed the State's attempt to label the tax as a mere

"privilege" tax that did not fall directly on the goods and determined that where "the incident which gave rise to the accrual of the tax was a step in the export process" (*id.* at 84), the tax constituted an impost upon an export and therefore was unconstitutional. *Id.* at 86.

Richfield is on all fours with the situation here: it invalidated a general state sales tax upon the transfer in the taxing jurisdiction of goods that were being sent abroad. The Tennessee tax therefore may survive only if *Richfield* no longer is good law.

C. The *Michelin* Analysis

As the Fifth Circuit recently noted, "*Richfield* has not been overruled." *Louisiana Land & Exploration Co. v. Pilot Petroleum Corp.*, 900 F.2d 816, 819 (5th Cir.), cert. denied, 111 S. Ct. 248 (1990). In *Michelin* and *Washington Stevedoring*, however, the Court announced a new test to determine whether a nondiscriminatory state tax levied on imported or exported goods no longer in transit violates the Import-Export Clause. This approach looks at the three policies that underlie the Clause:

> [T]he Federal Government must speak with one voice when regulating commercial relations with foreign governments, and tariffs, which might affect foreign relations, could not be implemented by the States consistently with that exclusive power; import revenues were to be the major source of revenue of the Federal Government and should not be diverted to the States; and harmony among the States might be disturbed unless seaboard States, with their crucial ports of entry, were prohibited from levying taxes on citizens of other States by taxing goods merely flowing through their ports to the other States not situated as favorably geographically.

Michelin, 423 U.S. at 285-286 (footnotes omitted); see *Washington Stevedoring*, 435 U.S. at 752-53.[27]

[27] The *Washington Stevedoring* Court stated that a State tax on exports "can be tested for its conformance with the first and third policies" enunciated in *Michelin*. 435 U.S. at 758. The second policy —protecting federal revenues—is not implicated because the Constitution forbids federal taxation of exports. U.S. Const., Art. I, § 9, cl. 5; see *Washington Stevedoring*, 435 U.S. at 758.

The *Michelin* Court held that the state property tax in that case did not violate any of the three policies, but emphasized that the levy was imposed "on imported goods *that are no longer in import transit.*" 423 U.S. at 286 (emphasis added); see *id.* at 302 (goods "were no longer in transit"). In so holding, the Court strongly suggested that the imposition of a tax on goods that *are* in transit could not stand, noting that "[i]n effect, the Clause was fashioned to prevent the imposition of exactions which were no more than transit fees on the privilege of moving through a State." *Id.* at 290 (footnote omitted). The Court therefore explained that the third purpose of the Clause "may be secured merely by prohibiting the assessment of even nondiscriminatory * * * taxes on goods which are merely in transit through the State when the tax is assessed." *Ibid.*

In *Washington Stevedoring*, the Court noted this limitation on the *Michelin* holding and left open the possibility that state taxes on goods in transit remain unconstitutional. Because the tax in that case fell "upon a service distinct from the goods and their value" (435 U.S. at 757), the *Washington Stevedoring* Court upheld Washington's business and occupation tax on stevedoring services. In so holding, the Court stated that it did "not reach the question of the applicability of the *Michelin* approach when a State directly taxes imports or exports in transit." *Id.* at 757 n.23.

Most recently, in *R.J. Reynolds*, the Court again "observed that in *Michelin* [the Court] limited its holding to the imported goods 'no longer in transit.'" 479 U.S. at 154 (citation omitted). The Court upheld the property tax there at issue because the imported material had

"nothing transitory about it." *Id.* at 155. *Richfield* is reconcilable with *Michelin* and *Washington Stevedoring* on that basis: the goods subject to the state sales tax in *Richfield* were in transit (they were actually heading into the hold of a foreign vessel) when the levy attached. See *Richfield* 329 U.S. at 82-83.

D. The *Richfield* Holding Is Valid After *Michelin*

In our view, the instinct that led the Court repeatedly to suggest that state taxes on goods in transit may be *per se* unconstitutional is sound. As one of the leading commentators in this area has explained, a

> basis for deciding the in-transit tax cases under the new Import-Export jurisprudence may be found in the purpose of the clause to prevent the seaboard States from exacting a tax on "goods merely flowing through their ports." A sales tax on goods being exported that is imposed at the point of delivery of title and possession of the goods to the purchaser or his shipper for transport to the purchaser can be fairly regarded as such an exaction and, therefore, as a "transit fee" that is repugnant to the Import-Export Clause.

I Hellerstein, *supra* § 5.4 at 189-90 (footnotes omitted). The Fifth Circuit has come to an identical conclusion, holding recently that the Clause invalidates "a [state sales] tax that is levied on the goods themselves while they are in transit." *Louisiana Land*, 900 F.2d at 820.

This case graphically demonstrates the wisdom of such an approach. The containers subject to tax simply pass through Tennessee en route to other destinations. The containers' only contact with the State is their delivery there to a common carrier for transfer elsewhere in the first step of an export journey; indeed, the containers were not subjected to tax *until* they were delivered to a common carrier for transport overseas. Tennessee thus is taking advantage of its "favorabl[e]" location (*Michelin*, 423 U.S. at 286) as a convenient spot for the transfer of containers to "exact[] a tax on 'goods merely flowing through [its] ports.'" I Hellerstein, *supra*, at 189. That aspect of the levy is made especially clear by the operation of the tax: once possession of a container is transferred in Tennessee, the State continues to tax the proceeds as the lessees' per diem obligations add up throughout the extended life of the lease. Tennessee thus asserts that, once the containers have passed through the State, it is permitted to impose a continuing tax on them as they accompany import and export shipments around the world. This is surely an appropriate setting for the invalidation "of even nondiscriminatory * * * taxes on goods which are merely in transit through the State when the tax is assessed." *Michelin*, 423 U.S. at 290.

It is worth adding that, if the Import-Export Clause is not understood to establish a *per se* bar on the taxation of goods in transit, it will serve hardly any purpose at all. The first and third elements of the *Michelin* test are essentially identical to policies already effected by the Commerce Clause, while the second *Michelin* policy has no bearing in cases involving exports.[28] Yet the

[28] The first element, which looks to the necessity that the Federal Government speak with "one voice when regulating commercial relations with foreign governments," requires "the same inquiry as to the effect of a state tax as the Foreign Commerce Clause." *Japan Line*, 441 U.S. at 449 n.14. The third prong of the *Michelin* test, the Court has added, is satisfied so long as the state tax satisfies the four-part *Complete Auto* test governing burdens on interstate commerce. See *Washington Stevedoring*, 435 U.S. at 754-755, 761. And the second *Michelin* factor (which certainly was not the principal policy underlying the Import-Export Clause, see generally *Michelin*, 423 U.S. at 283-285) does not come into play in cases involving exports. Although the Court has expressed skepticism that *per se* Import-Export Clause rules are necessary to distinguish that provision from the Commerce Clause (see *Washington Stevedoring*, 435 U.S. at 759), it did so before it announced the "one voice" Commerce Clause test in *Japan Line*.

Import-Export Clause "states an absolute ban [on imposts and duties], whereas the Commerce Clause merely grants power to Congress." *Washington Stevedoring*, 435 U.S. at 751. A firm bar against the taxation of goods in transit thus gives the former Clause an independent purpose that fulfills its role as a guarantor of "harmony among the States." *Michelin*, 423 U.S. at 286.[29]

In nevertheless rejecting Itel's Import-Export Clause argument, the court below ignored the fact that Itel's containers were in transit when the tax was assessed. Rather, the court found it crucial that "the transfer of possession of cargo containers is a discrete transaction"; that "Tennessee's tax only compensates the state for providing protective services, so the tax will not disturb harmony among the states"; and that "the indirect nature of the tax distinguishes it from the direct taxes held invalid in *Xerox* and *McGoldrick*." Pet. App. 18a. But this reasoning plainly is without substance. For reasons we explain above, a tax on a discrete transaction may preclude the Federal Government from speaking with "one voice" in its relations with foreign nations. The boilerplate suggestion that the State provides protection to containers traveling through its jurisdiction does not distinguish the Tennessee tax from any transit fee. See I Hellerstein, *supra*, at 187. And the sales tax here is no less directly imposed on the subject goods than were the sales taxes invalidated in *Richfield* and *McGoldrick*. Indeed, the Court has made clear that "[i]n *Richfield*, the tax fell upon the sale of goods and was overturned because the Court had always considered a tax on the sale of goods to be a tax on the goods themselves. * * * The sale had no value or significance apart from the goods."

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[29] Of course, for the reasons that we explain above in connection with the Commerce Clause, the Tennessee tax fails the "one voice" test. Thus, even without a *per se* ban under the Import-Export Clause, the Tennessee tax cannot survive scrutiny under the *Michelin* test.

Washington Stevedoring, 435 U.S. at 756 n.21. That is true here as well.

CONCLUSION

The decision of the Tennessee Supreme Court should be reversed.

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ITEL CONTAINERS INTERNATIONAL CORPORATION,

Petitioner,

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE, STATE OF TENNESSEE,

Respondent.

On Writ Of Certiorari To The Supreme Court Of Tennessee

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QUESTIONS PRESENTED

1. Whether a state sales tax levied on the privilege of engaging in business in the taxing state, which is measured by the gross proceeds derived by a lessor from lease contracts in which the leased property is located in and delivered to the lessee in the taxing state, is precluded by the Foreign Commerce Clause from being imposed on such leases of cargo containers which are ultimately used in international commerce.

2. Whether such a state tax is preempted by the Customs Conventions on Containers of 1956 and 1972.

3. Whether such a state tax is precluded by the Import-Export Clause.

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BRIEF OF RESPONDENT

STATEMENT OF THE CASE

Tennessee's sales tax is a conventional, widely-accepted form of state taxation, closely similar to the sales tax systems relied upon by over 40 other states for crucial state and local revenues.[1] Such taxes are normally imposed upon the privilege of engaging in retail sales or similar activities in the taxing state, local activities which directly enjoy the benefits and protections of the state. In

[1] All states except Delaware, Montana, New Hampshire, and Oregon impose some type of sales and use tax, distinct from other common revenue measures such as property tax and income tax. See 1A ALL STATES SALES TAX REP., ¶8-410 (CCH).

this particular case, Tennessee's generally applicable sales tax was imposed on a business which (1) has facilities and property located in Tennessee and (2) consummated its retail leases by delivering leased property within the state to its customers. The taxpayer is not itself an importer or exporter of goods in commerce or a shipper of such goods. Nonetheless, it claims that it is immune from state tax on its leases, because the taxpayer's customers ultimately use the leased property to transport the customers' goods in international commerce. The Tennessee courts correctly found that application of the sales tax (1) is not barred by agreements, statutes, or constitutional provisions reflecting international commerce concerns, and (2) is a fair exaction upon a business with local operations, to contribute its just share to the support of state and local government.

A. The Tennessee Sales Tax.

The Tennessee Retailers' Sales Tax Act imposes a privilege tax upon business activity occurring in Tennessee. Tenn. Code Ann. § 67-6-201[2] provides:

> It is declared to be the legislative intent that every person is exercising a taxable privilege who engages in the business of selling tangible personal property at retail in this state . . . or who rents or furnishes any of the things or services taxable under this chapter. . . .

The sales tax treats lease transactions the same as outright sales, recognizing the practical business reality

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[2] Tennessee statutes cited here are set forth in the appendix to this brief.

that a lease is but a sale for a limited duration. Taxable "sale" is defined as:

> *any transfer of* title or *possession,* or both, exchange, barter, *lease or rental,* conditional or otherwise, in any manner or by any means whatsoever of tangible personal property *for a consideration*. . . .

Tenn. Code Ann. § 67-6-102(23)(A) (Supp. 1991) (emphasis added).

The sales tax on lease transactions is levied "on the gross proceeds of all leases and rentals of tangible personal property in this state." Tenn. Code Ann. § 67-6-204(a). The rate of sales tax on leases is exactly the same as the rate on outright retail sales. Tenn. Code Ann. § 67-6-202. Thus, regardless of whether a transaction is labeled a "sale" or a "lease," if the actual "transfer of title or possession or both" of tangible personal property "for a consideration" occurs in Tennessee, such activity by the seller/lessor is taxable.

The incidence of the sales tax is not upon the property which is the subject of a transaction, or upon the transferee, but only upon the seller or lessor doing business in Tennessee. *Beare Co. v. Olsen,* 711 S.W.2d 603, 605 (Tenn. 1986). Although Tennessee statutes provide for the seller/lessor to pass the tax on to its customers, if possible, the legal burden of and ultimate liability to the state for the tax are only upon the seller/lessor. *Id.; Smoky Mountain Canteen Co. v. Kizer,* 193 Tenn. 598, 603, 247 S.W.2d 69, 72 (1952).

So long as the transfer of personal property occurs in Tennessee, from a transferor located in the state to a transferee present there, the seller/lessor is subject to tax, even if the transferee intends to and does export the

merchandise thereafter. *Jack Daniel Distillery v. Jackson*, 740 S.W.2d 413, 416 (Tenn. 1987). Such a transaction is taxable because the tax is upon the seller/lessor's ability to make a sale or lease precisely because it has facilities, employees, or product advantageously located in Tennessee, enjoying the benefits and protections of Tennessee government and society. Thus, for example, if a visitor to Tennessee buys a piece of furniture or rents a videotape and takes delivery in Tennessee, even though the items are used by the visitor entirely at his home in another state or even another country, sales tax would unquestionably be due from the seller or lessor.

On the other hand, Tennessee's sales tax laws expressly provide that

> It is not the intention of this chapter to levy a tax upon articles of tangible personal property imported into this state or produced or manufactured in this state for export.

Tenn. Code Ann. § 67-6-313(a).

This "import-for-export" exemption clearly establishes that if personal property is brought into Tennessee and then later sent out-of-state, without an intervening sale or lease transaction occurring, then the sales tax is not imposed. *Beecham Laboratories v. Woods*, 569 S.W.2d 456, 458 (Tenn. 1978). Only when some intervening transfer of title or possession for consideration occurs in Tennessee – that is, when a specific and substantial business activity occurs in Tennessee – does the tax become due. *Jack Daniel*, 740 S.W.2d at 416. Thus, the sales tax is based only upon discrete, but substantial, business activities occurring within Tennessee.

B. The Taxpayer.

Itel Containers International Corporation is a Delaware corporation, based in San Francisco, California. (Pet. App. at 27a; Stip. ¶4). Itel is not itself engaged in the import-export business or in international shipping, but is primarily engaged in the business of furnishing, as lessor, cargo containers to its customers for their use in transporting goods in international commerce. (Pet. App. at 28a; Stip. ¶5).

Itel's containers, while under lease, were used by Itel's customers exclusively in international commerce. However, Itel was not itself an importer, exporter, or shipper of any goods transported in such containers. Each container was brought into Tennessee at the conclusion of one lease and stored there until it was delivered to another customer at the beginning of another lease.

The Tennessee Department of Revenue assessed sales tax, penalty, and interest against Itel, attributable to Itel's transactions in Tennessee during the audit period of January 1, 1983, through November 30, 1986. (Pet. App. at 28a; Stip. ¶6). Sales tax was assessed upon Itel's transfers of possession to its leasing customers of cargo containers at the Tennessee locations where the containers were stored. (Pet. App. at 31a; Stip. ¶¶31 *et seq.*).

During the early part of the audit period, containers belonging to Itel were placed at "third-party" depots in such Tennessee locations as Memphis, Nashville, and Chattanooga. (Pet. App. at 31a; Stip. ¶32). Customers in need of cargo containers would arrange with Itel's offices outside Tennessee to lease the containers. Then, the customer or an agent of the customer would pick up and take delivery of the containers at the Tennessee location. (Pet. App. at 27a; Stip. ¶3).

Beginning August 1, 1985, Itel maintained a terminal of its own in Memphis, Tennessee. (Pet. App. at 31a; Stip. ¶33). The terminal, staffed by Itel employees, was used by Itel for receiving incoming containers being returned at the conclusion of their leases, storing containers, and making repairs. The terminal was also used as the site at which containers going out on lease were delivered to and picked up by Itel's customers. (Pet. App. at 31a; Stip. ¶¶32-37).

Throughout the audit period, Itel was registered with the Tennessee Department of Revenue as a dealer, and reported sales and use taxes on other transactions. (Pet. App. at 31a; Stip. ¶38).

C. The Decisions Below.

The courts below carefully applied the precedents of this Court in upholding the sales tax against Itel's constitutional challenges.

The case was tried before the Chancery Court for Davidson County, Tennessee. The Chancellor found that Itel located its facilities in Tennessee "for the business advantage of regional deliveries" and that advantage "is realized when [Itel] earns the right to payment by delivering over its containers to leasing customers in this state." (Pet. App. at 21a-22a). The court recognized that the sales tax "goes no further than this [in-state] portion of Itel's business." Further, the tax is nondiscriminatory because it is imposed "whenever any goods change hands for consideration in Tennessee." (Pet. App. at 22a). Therefore, the Chancellor found that the tax satisfied the elements of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), and that Itel was "simply being asked to pay

for what it is getting" in terms of state benefits and protections. (Pet. App. at 22a).

The Chancellor also considered and applied the analysis of *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), but found the facts of that case distinguishable, and found "no intrusions on international commerce" here. (Pet. App. at 21a-22a). Distinguishing the property tax in *Japan Line* from the sales tax in this case, the trial court recognized that "it is the value of doing business in this state that is being taxed, not the value of the cargo containers." (Pet. App. at 22a). Also, because the Tennessee tax is upon the initial transfer of possession of leased property, it falls upon "a one-time event in a lease that can only occur in one taxing jurisdiction." Therefore, "none of the risks of multiple taxation identified in *Japan Line*" are present here, and there is "no impairment of uniform [federal] trade regulation." (Pet. App. at 22a). Thus, the trial court rejected Itel's foreign commerce contentions, and upheld the assessment of $158,012.00 in sales tax, penalty, and interest.[3]

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[3] On another part of the assessment, however, the trial court ruled in favor of Itel. At trial, there was dispute as to whether tax was properly collected on so-called "shipper pool arrangements," in which shippers of goods intending to use overseas carriers would pick up empty cargo containers free of charge from Itel at Tennessee locations, and transport them to ports of exit outside Tennessee. Under shipper pool arrangements, the container leases would not commence, and thus Itel earned no right to receive rents, until the containers arrived at the ports outside of Tennessee. The trial court disallowed that portion of the assessment, holding that where delivery was consummated outside the state the transactions were not properly taxable by Tennessee. (Pet. App. at 20a-21a). That portion

(Continued on following page)

The Tennessee Supreme Court affirmed, after thorough analysis and application of this Court's pertinent decisions. The court began by recognizing that the Commerce Clause does not relieve those engaged in interstate or international commerce from their just share of local tax burdens "even though it increases the cost of doing business." *Itel Containers International Corp. v. Cardwell*, 814 S.W.2d 29, 34 (Tenn. 1991), *quoting Complete Auto*, 430 U.S. at 288. The court found the four Complete Auto factors to be satisfied, and proceeded to apply the *Japan Line* analysis. *Id.*, 814 S.W.2d at 36.

The Tennessee court held that the sales tax is imposed not on the value of Itel's containers, but on the transfer of possession of the containers in Tennessee, a "discrete transaction occurring only within Tennessee." *Id.*, 814 S.W.2d at 33, 36. Thus, the court found the sales tax distinguishable from the property tax in *Japan Line*, and more analogous to the sales tax on aviation fuel upheld in *Wardair Canada, Inc. v. Florida Dept. of Revenue*, 477 U.S. 1 (1986), and the business tax on stevedoring activities sustained in *Department of Revenue v. Association of Washington Stevedoring Cos.*, 435 U.S. 734 (1978). Further, because the tax falls only upon discrete transactions occurring only in one taxing jurisdiction, the court found no risk of true multiple international taxation. "The fact that other jurisdictions might tax other transactions involving these containers is irrelevant" and "clearly is not what is meant by 'multiple international taxation' in

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of the Chancery Court's holding was not appealed by the Department. Thus, the taxability of shipper pool leases is no longer at issue.

Wardair or *Japan Line*." *Itel*, 814 S.W.2d at 36n.8. For similar reasons, the court found that the sales tax here does not impair uniformity of federal policy in regulating foreign trade. *Id.*, 814 S.W.2d at 37.

Addressing the federal customs laws and the Customs Conventions on Containers, the court found that while Congress certainly has the power to prohibit state sales taxes on cargo container leases, it has not done so. The court found that, in fact, no evidence exists of congressional intent to confer advantages upon container companies other than exemption from customs duties and similar import or export taxes. *Id.*, 814 S.W.2d at 34. Because Tennessee's tax is not a customs duty, and is not at all a direct tax on goods in commerce, it does not violate the policies embodied in the Customs Conventions or the customs laws. *Id.*, 814 S.W.2d at 36-38.

Finally, the Tennessee court found that because the sales tax is upon business activity, and "not the value of the goods themselves," it is an indirect tax which does not violate the policy concerns of the Import-Export Clause. *Id.*, 814 S.W.2d at 37-38.

SUMMARY OF ARGUMENT

I.

A. The United States Constitution and decisions of this Court recognize the sovereign power of states to tax local business activities. Tennessee's sales tax is a generally applicable tax on local business activities, levied on a party doing business in this state. The tax on Itel's leases of cargo containers is not a direct tax on the containers themselves nor is it a property tax at all. Therefore, the

sales tax is completely distinguishable from the *ad valorem* property tax invalidated in *Japan Line,* 441 U.S. 434. The sales tax is imposed only when a transfer of title or possession of personal property for consideration occurs in Tennessee. Therefore, the tax is not imposed by reason of importation, or on mere transit through the state.

B. The Foreign Commerce Clause is not violated, because its policy concerns are not impaired by the Tennessee tax. Because the tax is on discrete transactions occurring only in Tennessee, it creates no risk of impermissible multiple international taxation. The fact that other nations may try to tax Itel's containers, or tax some other transaction involving the containers, is irrelevant and does not constitute the sort of multiple taxation with which the Foreign Commerce Clause is concerned. Itel's overly broad view would totally sacrifice the taxing power of the states to the vagaries of other nations' tax laws. Tennessee's tax is internally and externally consistent, and is a practical, reasonable, and widely-accepted means of taxing local business activities.

C. The tax does not impair the federal government's ability to speak with one voice in conducting foreign affairs. No clear federal directive is violated. The Customs Conventions on Containers do not apply, because the tax here is not levied on importation. Federal statutes and rules relieve Itel's cargo containers only from customs duties. The sales tax is simply not a customs duty. The state tax is not preempted by the general customs laws because there has been no clear expression of congressional intent to limit state taxing powers with regard to cargo containers. Further, this is not an area requiring uniform federal policy, because the sales tax here does not discriminate against or even act directly upon foreign

interests. Therefore, there is no realistic prospect of foreign retaliation such as would require a uniform national response.

II.

The sales tax here does not offend the Import-Export Clause. The sales tax simply is not a tax on imports or exports. Itel's containers are not themselves imports or exports. They are equipment used in foreign trade. The sales tax is generally applicable to Tennessee business activity, and therefore is not a tariff. Thus, the tax does not impair the federal government's "one voice" in foreign relations. The tax readily satisfies the four elements of the *Complete Auto* Commerce Clause analysis. Therefore, the tax does not implicate the policy concerns of the Import-Export Clause as analyzed in *Michelin Tire Corp. v. Wages,* 423 U.S. 276 (1976).

ARGUMENT

This case involves a sales tax, the most basic form of state and local taxation, imposed on businesses located in taxing states and limited to transactions taking place in those states. Indeed, it is the exercise of one of the most traditional and essential functions of state and local government in this country.

This case does not represent, as petitioner contends, "a collision between the power of the Federal Government and of a State to regulate foreign commerce." (Pet. Br. at 2). The United States as amicus curiae has found no collision. Respondent has found no collision. The reason

the supposedly colliding powers find no collision is simple: this case is not about the regulation of foreign commerce. This case does not involve foreign-owned property or a transaction taking place in a foreign country. It does not involve an importer, exporter, shipper, or foreign government. The tax involved does not apply to imported or exported goods or even to goods at all. The sales tax in this case is simply applied to container leases where possession is transferred in the taxing state.

The Tennessee sales tax is a generally applicable revenue system. The tax supports state and local government services by taxing, according to volume of business, those local business activities which benefit from such services. The fairness of the tax is shown by the breadth of its sweep; it is imposed "whenever any goods change hands for consideration in Tennessee." (Pet. App. at 22a). The tax is not targeted toward international commerce, and is by no means an attempt to regulate foreign trade. The focus is strictly upon business activity occurring in Tennessee's marketplace.

In this case, the sales tax fell upon a company doing substantial business in Tennessee. Itel is not itself in the business of importing or exporting goods in international commerce, and the tax here is not upon such goods. Itel does lease equipment to companies wishing to transport their goods in international shipping, but the tax is neither upon that equipment nor those customers. Instead, the tax is on Itel's activity in transferring that equipment to its customers for profit in Tennessee, measured by the consideration received by Itel in those transactions.

Thus, the tax in this case is not a tax on international commerce at all. It is simply an exercise of the state's sovereign taxing power. With due respect for the interests of the federal government, the goals of international relations, and most importantly, the requirements of the United States Constitution, taxation of such transactions is not prohibited.

I. TENNESSEE'S SALES TAX IN THIS CASE DOES NOT OFFEND THE FOREIGN COMMERCE CLAUSE.

Itel's primary challenge to the Tennessee sales tax in this case is based upon the foreign commerce element of the Commerce Clause, U.S. CONST. art. I, § 8, cl. 3. The Tennessee courts rejected those arguments, finding "no intrusions on international commerce." (Pet. App. at 21a).

When a state tax is alleged to interfere with the federal government's power under the Commerce Clause to regulate foreign commerce, two inquiries[4] are in order: (a) whether the tax creates a substantial risk of multiple taxation; and (b) whether the state tax prevents the federal government "from speaking with one voice when regulating commercial relations with foreign governments." *Wardair Canada, Inc. v. Florida Dept. of Revenue*, 471 U.S. 1, 8 (1986). So long as the state tax neither raises

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[4] The two foreign commerce inquiries are, of course, in addition to the familiar four-pronged analysis for interstate commerce under *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), which is readily satisfied here. See discussion *infra* at 43-48.

a substantial risk of multiple taxation nor impairs uniformity of federal policy regarding foreign commerce, the tax is constitutionally permissible. *Id.*

Itel bases its Foreign Commerce Clause argument almost entirely on the opinion in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979). The facts in *Japan Line*, however, are significantly different from those present in this case. In *Japan Line*, local governments imposed property tax on property owned by foreign nationals. The tax challenged in that case was an *ad valorem* property tax, not a privilege tax on discrete local activities such as Tennessee's sales tax. Further, the property taxed by California's local governments in *Japan Line* was also, in fact, taxed by Japan itself. *Id.*, 441 U.S. at 436.

In *Japan Line*, this Court expressly declined to rule on whether American states could constitutionally tax domestically owned instrumentalities used in foreign commerce. *Id.*, 441 U.S. at 444n.7. Instead, this Court carefully stated the issue in *Japan Line*, and thus the holding on that issue, extremely narrowly:

> The question here is a much more narrow one, that is, whether instrumentalities of commerce that are owned, based, and registered abroad and that are used exclusively in international commerce, may be subjected to apportioned ad valorem property taxation by a State.

Id., 441 U.S. at 444.

Thus, as the Tennessee Supreme Court found, it is abundantly clear that the *Japan Line* decision, while analytically instructive, is not dispositive of this case. *Itel*, 814 S.W.2d at 35.

A. Tennessee's Sales Tax Is Distinguishable From The Property Tax in *Japan Line*.

As the Tennessee Supreme Court has long recognized, as a matter of state constitutional law, the sales tax is not an *ad valorem* property tax, but instead a privilege tax on persons engaging in certain types of business activities in Tennessee. *Hooten v. Carson*, 186 Tenn. 282, 285, 209 S.W.2d 273, 274 (1948). Under the Tennessee Constitution, legislative authority is quite different in these two areas of taxation. The categorization of a particular tax is of state constitutional dimensions. TENN. CONST. art. II, § 28.

Property taxes are direct taxes on the value of the property, and therefore require some appraisal and assessment of the actual value, considering factors such as book cost, replacement cost, inflation, depreciation, and abstract fair market income potential. The Tennessee sales tax, on the other hand, is measured not by the value of the property, but by the total consideration, or the "gross proceeds," received under a contract of sale or lease.

Itel erroneously asserts that the rentals received under a lease are simply that portion of the value of the leased property corresponding to the time limits of the lease. Realistically, however, the consideration in a lease contract is simply a figure agreed upon by the parties to reflect numerous factors. The parties often may weigh the market position, strength, and volume of business enjoyed by the lessor more heavily than the actual value of the property. Often the consideration in a lease contract bears scant relationship to the actual value of the leased property.

As to leasing activity, Tennessee's sales tax is measured by the "gross proceeds" of the lease, which includes everything of value received by the lessor under the lease, and is not determined necessarily by the value of the leased property. *Furniture Lease Co. v. Tidwell,* 495 S.W.2d 535, 536 (Tenn. 1973). The taxable gross proceeds of a lease can include charges, often hidden or "built-in," for services rendered by the lessor in conjunction with the bare transfer of property. *Saverio v. Carson,* 186 Tenn. 166, 168, 208 S.W.2d 1018 (1948). By including charges for additional services, the taxable gross proceeds of leasing activity can in some instances actually exceed the value of the leased property. On the other hand, a lease of valuable personal property for a nominal rental would be taxable only to the extent of the nominal consideration, far short of the actual value of the property. The critical point is that the tax is upon the lessor's business activity, not the value of the leased property.

Further, an *ad valorem* property tax (like a customs duty) is an *in rem* tax for which the property itself is liable. Unpaid property taxes become a lien upon the property itself, for which the taxed property may be seized and sold by the proper authorities. *See, e.g.,* Tenn. Code Ann. § 67-5-2101. Sales taxes, in contrast, are taxes levied personally against the person or firm engaging in business. Delinquent sales taxes are not collected from or out of the personal property sold or leased; such property is by then already in the hands of the taxpayer's customer/transferee. Instead, unpaid sales taxes are collected by revenue authorities from the seller/lessor, out of whatever assets it may possess. *See, e.g.,* Tenn. Code Ann. § 67-6-517. The incidence of the sales tax, despite any pass-through provisions, is upon the seller/lessor.

Beare Co., 711 S.W.2d at 605; *Smoky Mountain Canteen,* 247 S.W.2d at 72.

Also, property taxes normally are recurrent and are assessed against the same property, as its value may increase or decrease, annually. In contrast, sales taxes are measured by discrete, one-time transfers of ownership or possession of goods. *See United States v. Sullivan,* 270 F.Supp. 236, 244 (D. Conn. 1967), *rev'd on other grounds,* 395 U.S. 169 (1969). When a retailer sells a piece of furniture or rents a videotape to a consumer, that transaction is subject to tax, but the same transaction is not subjected to the same tax again at a later date.

The distinctions between *ad valorem* property taxes and sales or privilege taxes are also important as a matter of state constitutional law. Article II, § 28, of the Tennessee Constitution describes in detail the means by which property may be taxed, and requires that the ratio of assessment to value of property "in each class or subclass shall be equal and uniform throughout the State." In contrast, that same section of the Tennessee Constitution empowers the legislature "to tax merchants, peddlers, and privileges, in such manner as they may from time to time direct." In applying those different provisions of article II, § 28, the Tennessee Supreme Court has long recognized the real differences between property taxes and privilege taxes. *See Hooten,* 209 S.W.2d at 274.

Therefore, Tennessee's sales tax is not a direct tax on property, and is not measured by the value of property. Instead, Tennessee's tax, measured by the gross proceeds of leases, is more akin to a tax on income derived from

leases. Such a tax is patently distinguishable from the flat, direct property tax in *Japan Line*.[5]

B. Tennessee's Sales Tax Does Not Create A Substantial Threat Of Impermissible Multiple International Taxation.

Itel relies heavily upon the *Japan Line* opinion to argue that in essence any state tax touching its international cargo containers, or any activity involving those containers, would unavoidably result in multiple international taxation impermissible under the Foreign Commerce Clause. However, Itel's broad-sweeping view of the concept of multiple international taxation would prohibit any state taxation of activity relating to international commerce, even though such activity is essentially local in nature. Such a view is contrary to the law.

In *Japan Line*, local governments in California assessed *ad valorem* property tax on cargo containers owned by a Japanese company. 441 U.S. at 436-37. The containers were also subject to property tax in Japan and were in fact taxed there. *Id.* Thus, the same type of tax on

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[5] In *Japan Line*, this Court took note of the Convention Between the United States of America and Japan for the Avoidance of Double Taxation, Mar. 8, 1971 [1972], 23 U.S.T. 967, 1084-85, T.I.A.S. No. 7365, which provided that income "derived by a resident of a Contracting State . . . from the use, maintenance, and lease of containers and related equipment . . . in connection with the operation in international traffic of ships or aircraft . . . is exempt from tax in the other Contracting State." *Japan Line*, 441 U.S. at 446n.10. Thus, as that international agreement, and this Court, recognized, a tax on proceeds derived from the lease of containers is plainly different from a direct property tax on the containers themselves.

the same property was imposed by multiple taxing jurisdictions. Because Japan certainly possessed the primary right and power to impose property tax on the full value of the containers owned and based in Japan, this Court found that California's local property tax produced multiple taxation in fact. *Id.*, 441 U.S. at 452.

In a later case, however, this Court recognized that no threat of multiple international taxation is created by a state tax imposed only on "a discrete transaction which occurs within one national jurisdiction only." *Wardair Canada*, 477 U.S. at 9. In *Wardair Canada*, this Court upheld a Florida tax on sales in Florida of aviation fuel used in foreign air commerce. *Id.*, 477 U.S. at 3-4. Because the tax was imposed only upon the sales of fuel, and only upon those sales occurring in Florida, the Court recognized that multiple international taxation was not possible. *Id.*, 477 U.S. at 9.

The distinction between *Japan Line*, where two jurisdictions taxed the same value of the same property, and *Wardair Canada*, involving a tax on a discrete transaction occurring only in the taxing jurisdiction, illustrates the meaning of the phrase "multiple taxation" as used in constitutional analysis. Multiple taxation means repeated taxation of the precise same act or event. Because the taxable event in *Wardair Canada* was the sale of fuel, and a particular sale could occur only at one time and in one place, that event was simply not subject to repeated taxation. The fact that some other jurisdiction might try to tax a different event, even though related to the same taxpayer or the same property, would not amount to constitutionally impermissible multiple taxation.

Furthermore, this Court has explicitly instructed that statements in the *Japan Line* opinion regarding overlapping taxes are not to be construed as an absolute prohibition on state-induced double taxation in the international context. *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 189 (1983). Thus, as demonstrated by *Wardair Canada*, state taxes on discrete taxable events occurring locally, even if related to international commerce, are not absolutely prohibited by the foreign commerce aspect of the Commerce Clause.

Fundamentally, the question of multiple taxation requires a practical inquiry. Itel apparently sees a threat of multiple international taxation in the possibility that another nation may tax some other aspect of the lease transactions taxed by Tennessee; for example, the use of the leased containers overseas. In the years since *Japan Line*, however, this Court has refined the analysis of such contentions in the interstate context. The likelihood of a state tax inducing impermissible double taxation is determined by examining whether the tax is internally and externally consistent. *Goldberg v. Sweet*, 488 U.S. 252, 109 S.Ct. 582, 588 (1989).

As the *Goldberg* Court explained, the internal consistency test requires that a tax be structured such that, if every other jurisdiction were to impose an identical tax, no multiple taxation would occur. *Goldberg*, 109 S.Ct. at 589; *citing Container Corp.*, 463 U.S. at 169. Thus, the test hypothesizes that other jurisdictions have enacted taxes identical to the one under scrutiny. *Id.*

For example, the interstate telecommunications excise tax in *Goldberg* was found to be internally consistent, because if every jurisdiction taxed only those telephone calls charged to an in-state address, only one state

would tax each call. Similarly, as to Tennessee's sales tax, if every state only taxed the transfer of possession of leased property for consideration within its borders, like Tennessee, only one jurisdiction would be able to tax each lease transaction. Tennessee's sales tax plainly is internally consistent.

In contrast, if every jurisdiction were to impose an identical *ad valorem* tax on personal property, then a given item could very well be subjected to taxation by multiple jurisdictions. Such a tax system would not be internally consistent.

The property tax in *Japan Line*, because it was peculiarly apportioned, might have satisfied the internal consistency standard for interstate commerce purposes. *Japan Line*, 441 U.S. at 445n.8. However, because apportionment cannot be ensured on a global basis, fair apportionment was insufficient to rescue that tax. *Id.*, 441 U.S. at 447. In a real sense, however, the *Japan Line* decision is compatible with the internal consistency analysis, as it might be adapted to the international context. Disregarding the apportionment features of the California tax, because other nations, such as Japan, would not be expected to apportion their property taxes, one would be forced to analyze the property tax as if it were imposed on the full value of the subject property. Viewed in such a way – hypothesizing that all other nations imposed the identical tax – the California property tax in *Japan Line* would have failed this international adaptation of the internal consistency test; if all nations imposed a full property tax on property located within their borders, a container located in a number of different countries over the course of a given tax year could likely be subjected to multiple property tax assessments. Use of the internal

consistency test to evaluate international multiple taxation problems thus addresses the *Japan Line* concerns regarding potential international friction. At the same time, it does not sacrifice the practicality and realism with which *Container Corp.* and *Goldberg* viewed business practices and state taxes.

Itel might argue, as did the unsuccessful appellant in *Goldberg*, that the inquiry should not focus on hypothetical identical taxes, but on similar, though not identical, taxes that other nations unaccustomed to American notions of conventional taxation might choose to impose. However, as the *Goldberg* Court, pointed out,

> If we were to determine the internal consistency of one State's tax by comparing it with slightly different taxes imposed by other States, the validity of state taxes would turn solely on "the shifting complexities of the tax codes of 49 other States."

Goldberg, 109 S.Ct. at 589, *quoting Armco, Inc. v. Hardesty*, 467 U.S. 638, 645 (1984).

The same logic should apply with equal force in considering international multiple taxation. If an American state's taxation efforts were to rise or fall solely upon comparison with the "shifting complexities" of the tax laws of all of the nations on earth, in practical effect the states would be absolutely prohibited from taxing any thing or activity in any way touching, however remotely, international commerce. The internal consistency test of *Container Corp.*, *Goldberg*, and their progeny suggests a rational response to the practical reality that reasonable taxation of local activities by states should not be held hostage by the vagaries of French, Japanese, or a hundred other nations' tax laws. In the international context as

well as between states, such a rule of reason is preferable to strict technicalities. *Container Corp.*, 463 U.S. at 190.

In any event, as the *Goldberg* Court noted, to the extent that other jurisdictions in fact impose taxes creating multiple taxation, such concerns are addressed by applying the external consistency test to the challenged state tax. That test turns on whether the state tax is measured by only that portion of the interstate (or international) activity which "reasonably reflects the in-state component of the activity being taxed." *Goldberg*, 109 S.Ct. at 589; *Container Corp.*, 463 U.S. at 169-70. The focus is on the practical or economic effect of the tax.

Again, in *Goldberg* the excise tax on interstate telephone calls was found to be externally consistent because its economic effect was like that of a sales tax, and the tax "reasonably reflect[ed] the way that consumers purchase interstate telephone calls." *Goldberg*, 109 S.Ct. at 589. Similarly, in this case, Tennessee's tax is reasonably measured by the in-state activity taxed: Itel's activity in locating its facilities, employees, and product in Tennessee for the profitable purpose of making convenient deliveries to customers.

Furthermore, the economic effect of Tennessee's tax more than resembles a sales tax; it is in fact a sales tax. Itel suggests that the tax is improperly apportioned and creates a risk of multiple taxation because the leased containers are used by the lessees outside of Tennessee, and such usage could itself be taxed. However, the same could be said of the situation in which a souvenir trinket imported from Taiwan is purchased in Nashville, Tennessee, by a German tourist who immediately flies home with his treasure, never to return. The tourist's home nation might impose a use tax on the souvenir. Still, the

gross sales price of the trinket would without doubt be subject to tax under the laws of Tennessee or virtually any other state with a sales tax. This Court has never gone to the extreme of invalidating such a tax. *See, e.g., McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33 (1940). Practical economic realities – the substantial activities of the seller in the taxing jurisdiction, culminating in a transfer by sale or lease – dictate that such a transaction should be subject to the state's taxing power.

The Tennessee Supreme Court correctly reasoned that the possibility of other nations imposing different taxes on different transactions involving Itel's containers should not be considered impermissible multiple international taxation. *Itel*, 814 S.W.2d at 36n.8. Tennessee's sales tax in this case is a realistic effort to tax business activity actually occurring within this state. The tax is consistent both internally and externally. The tax does not create any substantial threat of multiple international taxation of the sort which would offend the Foreign Commerce Clause.

C. The Sales Tax In This Case Does Not Impair Uniformity Of Federal Policy On Foreign Commerce.

As noted, a state tax affecting foreign commerce may be invalid if it prevents the federal government "from speaking with one voice when regulating commercial relations with foreign governments." *Wardair Canada*, 477 U.S. at 9. A state tax fails the "one voice" test if it either violates "a clear federal directive" or implicates foreign policy issues which by their nature require uniform treatment by the federal government. *Container Corp.*, 463 U.S. at 194.

1. Sales tax on the transfer of possession of Itel's containers in Tennessee does not violate any clear federal directive.

Itel cannot point to any express federal policy, or "clear federal directive," prohibiting the Tennessee sales tax challenged in this case. Despite Itel's insistence, federal statutes and regulations, and the Customs Conventions on Containers of 1956 and 1972, fall far short of embodying any such clear federal policy.

a. The Customs Conventions on Containers do not preclude state sales taxes.

The Customs Conventions so broadly relied upon by Itel do not address state taxes on purely local activities. Still, Itel asserts that the imposition of Tennessee's sales tax upon the lease transactions in this case "cannot be reconciled with the language of the [1956 and 1972] Conventions [on Containers]." (Pet. Brief at 12). The specific language of these Conventions upon which Itel relies are the definitions of "import duties and taxes":

> 1956 Convention:
>
> The term "import duties and import taxes" shall mean not only Customs duties but also all duties and taxes whatsoever *chargeable by reason of importation*.
>
> 1972 Convention:
>
> The term "import duties and taxes" shall mean Customs duties and all other duties, taxes, fees and other charges which are *collected on, or in connexion with, the importation of goods*, but not including fees and charges limited in amount to the approximate cost of services rendered.

Customs Convention on Containers, art. I(a), May 18, 1956 [1969] 20 U.S.T. 301; Customs Convention on Containers, art. I(a), December 2, 1972, [1985] 988 U.N.T.S. 43 (emphasis added).

Under both Conventions, containers are granted temporary admission into signatory nations "free of import duties and import taxes . . . . " *Id.* According to Itel, the Tennessee sales tax is "inconsistent with the plain terms of the Container Conventions." (Pet. Brief at 12). The essence of Itel's argument is that the Tennessee sales tax is "triggered in a direct sense by the entry of goods into the taxing jurisdiction." (Pet. Brief at 14).

The critical flaw in Itel's argument lies in that conclusion. The Tennessee sales tax plainly is not triggered by the importation of the containers into the borders of Tennessee. The sales tax is *not* a tax "changeable by reason of importation," or "collected on, or in connexion with, the importation of goods," as those terms are used in the Customs Conventions on Containers. The Tennessee tax simply is not levied on imports, but is a generally applicable tax. Moreover, it is not the entry into Tennessee that triggers the tax, but a transfer within Tennessee to another party for consideration.

Many imported items are never involved in taxable transactions in light of the "import-for-export" exemption expressly provided by Tenn. Code Ann. § 67-6-313(a). *Beecham Laboratories*, 569 S.W.2d at 458. The assertion that sales tax on Itel's leases of its containers is a tax on imports, because the containers would not be in Tennessee but for importation, is simply illogical. It implies that an obviously necessary condition, presence in the state, is also sufficient causation for the tax to be imposed. As

illustrated by the "import-for-export" exemption, importation does not determine taxability; assuming purely for argument's sake that Itel's containers are "imported" into Tennessee, many such containers are never involved in transactions taxable in Tennessee.[6] The Customs Conventions on Containers, so broadly relied upon by Itel, do not even address, much less forbid, Tennessee's sales tax.

This Court has indicated a willingness to look not only at the text of a treaty when interpreting it, but also at "the context in which the written words are used." *Air France v. Saks*, 470 U.S. 392, 397 (1985). *See also United States v. Alvarez-Machain*, No. 91-712, slip op. at 11 (U.S. June 15, 1992) (Court looked to language of a treaty "in the context of its history"). The context within which the Container Conventions of 1956 and 1972 were written reveals an intent to free such containers from the imposition of traditional customs duties and import taxes, *not* to immunize from taxation all transactions which in any way touch upon such containers. The origins of the Container Convention of 1956 are found in the rebuilding of Europe after World War II through the Economic Commission for Europe (ECE). In particular, the Inland Transport Committee (ITC) of the ECE adopted a number of resolutions in the early 1950's pertaining to customs duties and the transport of goods throughout Europe. *See, e.g.*, Resolution 117 on Temporary Importation of Pleasure Craft, U.N. Doc.

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[6] This reality was recognized by the trial court in this case when it disallowed tax on transactions in which Itel delivered containers from its Tennessee locations, but where the transfer of possession to the lessee for consideration occurred outside Tennessee. (Pet. App. at 20a-21a).

E/ECE/TRANS/453 (1954); International Customs Convention on Touring, U.N. Doc. E/ECE/TRANS/SC1/155 (1953).

In 1950, the ITC submitted a Draft Customs Convention on International Transport of Goods by Road to the ECE. *See* U.N. Doc. E/ECE/109 (1950). The purpose of this proposal was to permit the "international transport of goods by road under the terms of the Convention without breaking of bulk across one or more frontiers between a customs office of departure of one contracting state and a customs office of destination of another contracting state, or of the same state." *Id.* at Ch. 2, art. II. The definition of "import or export duties" under this Draft Convention is virtually identical to the definition of "import duties and import taxes" in the 1956 Convention.[7] The 1950 Draft Convention focused upon traditional national customs duties and taxes on importation. The Tennessee sales tax is not a tax upon importation but upon a separate and distinct leasing transaction occurring in Tennessee.

In 1954, the ITC adopted a resolution which was the forerunner of the 1956 Convention. *See* Temporary Duty-Free Admission of Containers, Resolution No. 173, U.N. Doc. E/ECE/TRANS/449 (1954). Once again, the ITC focused upon traditional national customs duties and

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[7] The definition contained in the 1950 Draft Convention states that "the terms import or export duties and import or export taxes shall mean not only Customs duties but also all duties and taxes whatever chargeable by reason of importation or exportation other than any fees which may be chargeable for sanitary inspection and charges in the nature of statistical fees." Draft Customs Convention on International Transport of Goods By Road, U.N. Doc. E/ECE/109 (1950).

import taxes as the subject of concern, stating that "pending the conclusion of a general agreement on containers, it would be highly desirable for governments to incorporate in their *national customs regulations as uniform measures as possible in respect of the temporary duty-free admission of containers . . . .* " (emphasis added). *Id.* The 1956 Convention was drafted in the context of removing traditional national customs duties and import taxes as barriers to the transport of sealed containers throughout Europe. There is no affirmative indication of any intention that a sales tax such as Tennessee's upon leasing transactions was even contemplated under the Convention.[8]

The reason for the adoption of the 1972 Convention was not to ensure that "the breadth of the [import tax] prohibition is magnified" from the 1956 Convention as asserted by the petitioner. (Pet. Brief at 13). Rather, the 1956 Convention had become technologically and economically obsolete as noted by the Secretariat of the United Nations:

> As a result of the considerable increase in numbers of containers used in international traffic following the "container revolution," and because of the production of large series of containers in accordance with the same design type and on account of the need for both simplifying customs formalities and facilitating container

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[8] *See Alvarez-Machain*, slip op. at 7, in which the Court, in upholding the abduction of a Mexican national as not in violation of an extradition treaty between the United States and Mexico, noted that the treaty "says nothing about the obligations of the United States and Mexico to refrain from forcible abductions of people from the territory of the other nation, or the consequences under the Treaty if the abduction occurs."

> transport, the provisions of the 1956 Convention became obsolescent, obsolete and inadequate.
>
> The ITC [Inland Transport Committee] of the ECE [Economic Commission for Europe] decided to study how the provisions of the Conventions could be brought into line with technology and economic development and facilitation requirements.

United Nations Conference on International Container Traffic, Customs Questions Note By Secretariat, U.N. Doc. E/CONF.59/2 at 1 (1972).[9]

Also, the Secretariat discussed the need for registration of containers in order to avoid either no or double taxation on importation of such containers. In arguing for a registration system for containers, the Secretariat stated the following:

> A container is not an ordinary piece of merchandise, but a piece of transport equipment. So far it has been used mainly for international transport, but its use for domestic carriage in individual countries is increasing fast. The present situation has led to the formation of a stock of stateless containers, which have not complied with the fiscal requirements of any country and can therefore compete abnormally with the equipment used in domestic traffic. The present state of confusion, as it must be called, will not lead to a liberal development of international

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[9] The Secretariat's note also refers to "import duties and taxes on importation" which lends additional support to the view that the prohibition is against a tax directed *solely* at importation of containers. *Id.* at 46. Of course, Tennessee sales tax applies to the leasing transaction, irrespective of importation.

> container traffic, but may well cause some countries to adopt protective measures.

Id. at 59/16/Addendum 2 at 3.

The purposes of the Container Conventions of 1956 and 1972 are to remove the traditional customs duties and import taxes which would otherwise be imposed upon containers used in international commerce. The Secretariat in seeking a registration system for such containers raised concern about such containers operating tax free in unfair competition with domestic containers. Itel seeks to expand this benefit one huge step further by eliminating taxes not only upon the containers themselves but upon transactions occurring in certain jurisdictions which pertain to the containers, i.e., the Tennessee sales tax upon the leasing transactions occurring in Tennessee. Such an expansive view of the Conventions was not intended under either the 1956 or 1972 Convention.

By reading the Customs Conventions as prohibiting all taxes whatsoever relating to containers, Itel reduces the phrases "chargeable by reason of importation" and "collected on, or in connexion with, the importation of goods" to meaningless surplusage. However, this Court has indicated that all words in a treaty should be given meaning if possible. *Factor v. Laubenheimer,* 290 U.S. 276 (1933). International conventions and treaties simply cannot be construed to ignore language as Itel would wish.

The sales tax in this case was imposed only upon the privilege of engaging in business in Tennessee as reflected by the transfers of possession in Tennessee of tangible personal property for consideration. Tenn. Code Ann. §§ 67-6-201, -204, and -102(23)(A). The tax is not a prohibition or restriction on imports, and indeed there is no relation whatsoever to importation. Instead, the tax

here was measured by the transfers of containers which were already present in this state. Further, the tax was assessed against Itel, which is not even a party to importation of goods, but merely leases equipment to other companies which are engaged in the import-export trade. The Tennessee sales tax is not, by any contortion of logic, "chargeable by reason of importation," but is merely a privilege tax on activities occurring only in Tennessee.

b. No federal statute prohibits Tennessee's tax.

The federal statute cited by Itel, 19 U.S.C. § 1322(a), provides only that items such as Itel's containers shall be exempt from federal customs laws:

> Vehicles and other instruments of international traffic, of any class specified by the Secretary of the Treasury, *shall be granted the customary exceptions from the application of the customs laws* to such extent and subject to such terms and conditions as may be prescribed in regulations or instructions of the Secretary of the Treasury.

19 U.S.C. § 1322(a) (emphasis added).[10] The regulations issued under that statute go no further than to provide the exception from federal customs duties as directed by Congress. *See* 19 C.F.R. § 10.41a. Tennessee's sales tax is definitely not a federal customs duty, and is not even described, much less prohibited, by 19 U.S.C. § 1322 or the corresponding regulations. Yet, had Congress intended 19 U.S.C. § 1322 to exempt instruments of international traffic from state taxes, it could easily have done so.

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[10] That statute was amended in 1984 to substitute the words "shall be excepted" for "shall be granted the customary exceptions." 19 U.S.C. § 1322(a) (Supp. 1990).

While the federal statute and regulations and the Custom Conventions facilitate the use of containers in international commerce by removing duties, taxes, prohibitions, and restrictions normally applicable to imports, nowhere do federal laws or treaties expressly or otherwise bar state taxes not imposed on importation.[11] The Tennessee sales tax in this case does not violate any clear federal directive, law, or policy.

c. Tennessee's tax is not preempted by the federal customs laws.

Notwithstanding the total absence of any clear federal directive barring state taxation of Itel's containers, Itel argues that the federal statute (19 U.S.C. § 1322(a)) and regulation (19 C.F.R. § 10.41a) and the Customs Conventions on Containers amount to a "pervasive" scheme of regulation. Itel contends that such federal regulation preempts, under both the Commerce Clause and the Supremacy Clause (U.S. CONST. art. VI, § 2), any and all state action regarding international cargo containers.

Itel's preemption argument leans almost exclusively upon cases involving state taxation of goods located in government-supervised, customs-bonded warehouses. *Xerox Corp. v. County of Harris, Texas,* 459 U.S. 145 (1982); *McGoldrick v. Gulf Oil Corp.*, 309 U.S. 414 (1940). In those cases, this Court held essentially that state taxes on goods stored under Customs Service supervision in bonded warehouses are preempted by the comprehensive federal

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[11] Itel itself has recognized that preemption in this situation is disfavored ("preemption is disfavored in cases involving federal statutes because Congress is presumed not to have sought to displace state law.") (Pet. Br. at 14n.12).

regulations of customs duties. *Xerox*, 459 U.S. at 154. (*But see R.J. Reynolds Tobacco Co. v. Durham County, N.C.*, 479 U.S. 130, 152 (1986), which limited the holding in *Xerox* by upholding a state property tax on goods in a customs-bonded warehouse when the goods are destined for domestic sale). However, the federal customs warehouse statutes found in *Xerox* and *McGoldrick* to be so "comprehensive" and preemptive are significantly different from the statute addressing cargo containers, and are based upon completely different federal policies. Therefore, the *Xerox* and *McGoldrick* decisions do not control this case.

The *Xerox and McGoldrick* cases involved the specific statutes pertaining to customs-bonded warehouses, which in their most recent incarnation are found at 19 U.S.C. §§ 1555 and 1557. Those statutes provide that imported goods may be stored, duty free, for specified periods of time, in government- supervised bonded warehouses. *Xerox*, 459 U.S. at 150; 19 U.S.C. § 1555(a). While in those bonded warehouses, the goods are in the joint custody of the United States Customs Service and the warehouse proprietor, and under the continuous control and supervision of the customs officers. *Id.* The United States Customs Service "is in charge" of the warehouse and all work performed there is under its "supervision." *Xerox*, 459 U.S. at 148n.2; 19 U.S.C. § 1555. Detailed federal regulations control every aspect of the operation of such warehouses. *Xerox*, 459 U.S. at 150.

In contrast, the statute cited by Itel as "pervasively" regulating cargo containers, 19 U.S.C. § 1322(a), merely provides that "instruments of international traffic . . . shall be excepted from the application of the customs laws." While customs warehouses are regulated in every detail by federal law and in fact are directly

supervised by the Customs Service, pursuant to 19 U.S.C. § 1555, cargo containers, under 19 U.S.C. § 1322, are merely "excepted" from customs laws. The bonding requirements for containers, so stressed by Itel, merely help identify the instrumentalities intended to be exempt from customs. Containers are not under the supervision and certainly not in the custody of customs officers. Containers are not located in the discrete "enclaves" created by customs warehouses, but may be found wherever companies such as Itel and its customers choose to place them. The bonding requirements for customs warehouses, on the other hand, trigger direct, detailed supervision and custody by federal customs officers. Clearly, the federal statute and regulations regarding cargo containers do not begin to approach the comprehensive nature of the laws governing customs warehouses as analyzed in *Xerox* and *McGoldrick*.

Further, in determining whether federal law preempts state action, the courts must "give primary emphasis to the ascertainment of congressional intent." *R.J. Reynolds*, 479 U.S. at 152. In view of the "sensitive interrelationship" of federal and state sovereignty, this Court has recognized that

> we must be mindful of the principle that "federal regulation of a field of commerce should not be deemed preemptive of state regulatory power in the absence of persuasive reasons – either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained."

Id., (citations omitted).

In *Xerox*, legislative history explicitly showed that the customs warehouse laws were intended by Congress "to stimulate business for American industry and work for

Americans." *Xerox*, 459 U.S. at 151. By waiving customs duties on goods intended for reexportation from the warehouses, the warehouse laws were explicitly intended to make American ports more attractive and convenient places for transshipment of goods in foreign commerce. *Id.* By creating a system of duty free customs warehouses, Congress sought "to encourage merchants here and abroad to make use of American ports." *Id.* Thus, the Court has recognized that the express congressional policy underlying the customs warehouse laws was to protect and promote domestic business, and indeed to create an affirmative competitive advantage for American industry and labor over their foreign counterparts. State taxation which would operate to "lessen the competitive advantage conferred on the importer by Congress" would thus violate the purposes of the warehouse laws. *Id., citing McGoldrick*, 309 U.S. at 429. In such a case, a finding that federal law preempted state action would be appropriate.

While the customs warehouse laws were intended to create a positive competitive advantage for American business, and thus a relative disadvantage to foreign competitors, there is no evidence of any similar congressional intent regarding cargo containers. As argued above, the Customs Conventions on Containers prohibit only duties, taxes, and restrictions by reason of importation, and presumably leave all of the signatory countries free to impose other taxes, including local taxes, not tied to importation. Federal law, 19 U.S.C. § 1322(a), and the related regulations, similarly relieve international cargo containers only "from the application of the customs laws."

In the absence of some clear federal policy, unmistakably ordained by Congress, which would be violated by the sales tax in this case, Tennessee's sales tax should not be considered preempted by federal law.

2. The tax in this case does not intrude upon any area requiring uniformity of federal policy regarding foreign trade or relations.

The question whether a state tax intrudes upon areas requiring uniform federal foreign policy usually arises where the state action would provoke retaliation by foreign governments against the United States as a whole. *Container Corp.*, 463 U.S. at 194. In that context, the courts are faced with the difficult task of balancing the particular risks of foreign retaliation against "the sovereign right of the United States as a whole to let the States tax as they please." *Id.*

In this case, the sovereign right of the United States to allow its constituent states to impose taxes, and the sovereign power of the State of Tennessee to impose taxes based upon local activities, are not outweighed by any risk of foreign retaliation, because there is no reasonable and substantial risk of such retaliation.[12] Itel's efforts to imagine scenarios of foreign retaliation are based upon a

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[12] *See Container Corp.*, 463 U.S. at 203n.4 (Powell, J., dissenting) in which similar protests from our principal trading partners failed to sway this Court into invalidating a reasonable state tax.

misunderstanding of the legal effect of Tennessee's tax, and a faulty analysis of the economic effect of the tax.

As discussed above, the legal incidence of Tennessee sales tax is upon the vendor or seller/lessor, not the customer or vendee. *Beare Co.*, 711 S.W.2d at 605. Thus, because Itel is the lessor and the transferor of the taxable property in this case, the incidence of the tax is upon Itel. The mere fact that statutory provision is made for Itel, if possible, to pass the tax on to its customers does not change the reality that the legal burden of the tax is only upon Itel. *Id.; Smoky Mountain Canteen*, 247 S.W.2d at 72. Therefore, the tax in this case is not imposed on foreign nationals or foreign interests as such, but upon Itel, a domestic corporation which freely chose to locate its operations in Tennessee.

Although Itel may recoup the tax paid to Tennessee by raising its prices to its foreign customers, Itel is not thereby passing on the tax any more than it is passing on one of its costs of doing business, just as it might pass along to customers other expenses such as steel prices, labor or overhead costs. If the market will not bear the increased cost, Itel might have to absorb those costs by lowering its prices, or else lose business. Customers, foreign or domestic, who think Itel's (or any other Tennessee lessor's) effective prices are too high because of the added cost of Tennessee's tax will lease containers elsewhere. Of course, overhead and other costs of doing business might actually be lower in Tennessee than in some locations, thereby offsetting any increase in the seller/lessor's costs that might be attributable to sales tax burden. For locating in Tennessee and enjoying the benefits of making sales and leases in Tennessee, Itel is legally required to pay sales tax. Tennessee's tax does not burden

foreign entities or interests; the tax here is a burden, if at all, only upon the market position of Itel. No rational foreign government would retaliate against a Tennessee tax which burdens, if anyone, only Tennessee business activities.

This case is decidedly unlike *Japan Line*, in which state taxes were imposed directly upon the property of foreign nationals. Even if Japan had not already imposed its own tax on such property, it could reasonably be expected in such circumstances to retaliate against an American tax on Japanese property by imposing a Japanese tax on American property. That real threat of retaliatory action by a foreign government underscored the need for uniformity of action and policy by the United States government, and thus militated against the attempted taxation of foreign property by individual states.

In the present case, there exists no reasonable prospect of foreign retaliation against Tennessee's sales tax. Therefore, there is no need for uniform federal action or policy, and the Tennessee tax impedes no such federal policy.

Itel (Brief at 31) and the United Kingdom (Amicus Brief at 7-9) argue that foreign nations into which the containers may wander would have sufficient nexus to tax the use of the containers, thus duplicating the Tennessee sales tax. However, if a container is imported into the United Kingdom and subsequently is exported while the same lease is in effect – that is, no intervening sale or lease transfer occurs while the container is in the United Kingdom – then such a use tax by the United Kingdom would simply be a tax upon the container's presence in the United Kingdom, or would be a tax on "mere transit"

through that nation. Such a tax would be far more akin to a tax upon importation than is Tennessee's tax, and therefore would probably violate the Customs Conventions on Containers so relied upon by Itel. Thus, Itel's arguments in this case point more to the invalidity of the imaginary, retaliatory taxes of foreign nations than of Tennessee's tax system.

The taxing powers of American states should not be paralyzed by the speculative possibility that another nation might claim to have taxing nexus when it does not, or that another nation might try to impose some other discriminatory or improper tax against which the United States might have justifiable grounds for protest. If Tennessee's tax is reasonable, practical, and justifiable as an appropriate means of taxing in-state business activity, the "one voice" standard should not require Tennessee or other states to yield before the possibility of an irrational or ulterior foreign tax.

Certainly the constitutional need of the United States government to "speak with one voice" in foreign affairs does not require a state to endure exploitation of its marketplace by businesses involved in international trade, without the ability to tax the purely local aspects of such business activities that enjoy benefits and protections furnished by the state. Prohibition of such state taxes would in effect force states to subsidize foreign trade at the expense of those local businesses which are forced to contribute to the state's revenues. Absent some unmistakably clear effort by the federal government to require such subsidies for foreign trade, the interests of the states and of local businesses should not be so constrained.

The sovereign right of Tennessee to tax local activities does not collide with federal policy concerns. The sales tax collected from Itel is constitutionally sound.

II. THE SALES TAX IN THIS CASE DOES NOT VIOLATE THE IMPORT-EXPORT CLAUSE.

Itel contends that the sales tax on its transfers of cargo containers in Tennessee violates the Import-Export Clause, which provides:

> No state shall, without the consent of the congress, lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws; and the net produce of all duties and imposts, laid by any state on imports or exports, shall be for the use of the treasury of the United States; and all such laws shall be subject to the revision and control of the congress.

U.S. CONST. art. I, § 10, cl. 2.

Of course, the tax in this case was not levied on any imports or exports. Itel's containers were not themselves goods in commerce, but were merely vehicles for transporting imported or exported goods. *See Canton R.R. v. Rogan*, 340 U.S. 511 (1951). The sales tax on leases of items used in handling or transporting goods to be exported is thus much closer to the business and occupation tax on stevedoring activities that was upheld in *Department of Revenue v. Association of Washington Stevedoring Cos.*, 435 U.S. 734 (1978).

In any event, early decisions under the Import-Export Clause often "assumed that all taxes on imports and exports and on the importing and exporting processes were banned by the Clause." *Id.*, 435 U.S. at 752 (describing earlier cases such as *Richfield Oil Corp. v. State*

Bd. of Equalization, 329 U.S. 69 (1946)). In *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976), however, the Court "specifically abandoned" the prior analysis, and instead shifted the focus to the question whether a challenged state tax constitutes an "impost or duty." *Limbach v. Hooven & Allison Co.*, 466 U.S. 353, 360 (1984).

Since *Michelin*, Import-Export Clause analysis examines whether a challenged state tax offends any of the three policy considerations identified by the Court as underlying the Clause:

> The Framers of the Constitution thus sought to alleviate three main concerns . . . : [1] the Federal Government must speak with one voice when regulating commercial relations with foreign governments, and tariffs, which might affect foreign relations, could not be implemented by the States consistently with that exclusive power; [2] import revenues were to be the major source of revenue of the Federal Government and should not be diverted to the States; and [3] harmony among the States might be disturbed unless seaboard States, with their crucial ports of entry, were prohibited from levying taxes on citizens of other States by taxing goods merely flowing through their ports to other States not situated as favorably geographically.

Washington Stevedoring, 435 U.S. at 752-53, *quoting Michelin*, 423 U.S. at 285-86.

A. Tennessee's Sales Tax Satisfies The *Michelin* Analysis.

The sales tax challenged by Itel in this case does not offend any of the policy considerations underlying the Import-Export Clause. As argued above, the tax does not

interfere with the federal government's ability to "speak with one voice" in regulating commerce with foreign governments. As the trial court correctly recognized, the sales tax is generally applicable "whenever any goods change hands for consideration in Tennessee." (Pet. App. at 22a). The Tennessee sales tax is a general business tax that applies to virtually all businesses in the state, and thus does not create any special protective tariff, such as the Framers intended to prohibit. *Washington Stevedoring*, 435 U.S. at 753.

As to the second policy concern of the Import-Export Clause, the Tennessee sales tax does not deprive the federal government of any revenues to which it is entitled. Under 19 U.S.C. § 1322(a), Itel's cargo containers are exempt from federal customs duties in any event. Further, there is no evidence that application of the Tennessee sales tax would significantly diminish the number of imports on which the federal government could levy import duties. *Washington Stevedoring*, 435 U.S. at 753. Also, as argued above, Tennessee's tax bears no relation to the importation of the containers, but is a tax purely on the business of transferring the containers to other parties within the state for consideration. If Itel imported containers and then itself exported them from Tennessee, without transferring them to lessees while in Tennessee, the sales tax would not be imposed. *Beecham Laboratories*, 569 S.W.2d at 458. Thus, the Tennessee sales tax is clearly not a tax on imports.

Analysis under the third Import-Export Clause element, involving the prevention of interstate rivalry and friction, is substantially identical to the Commerce Clause analysis described by the Supreme Court in *Complete Auto*, 430 U.S. 274. The third Import-Export Clause policy

is thus vindicated if the taxpayer has reasonable nexus with the taxing state, the tax is properly apportioned, is nondiscriminatory, and is reasonably related to services provided by the state. *Washington Stevedoring*, 435 U.S. at 755; *Complete Auto*, 430 U.S. at 279. The four *Complete Auto* factors are readily satisfied by the Tennessee sales tax, and are not seriously disputed by Itel.

First of all, Itel clearly had nexus with Tennessee in this case. The Itel containers which were the subject of the taxed lease transactions were physically present in Tennessee. From and after July 1, 1985, Itel had employees located in Tennessee directly involved in delivery of the containers and related activities, and after August 1, 1985, Itel maintained a terminal in Memphis for handling such deliveries. (Pet. App. at 31a; Stip. ¶33 *et seq.*) Prior to that time, Itel containers were present at "third party" depots located in Tennessee, from which the containers were delivered to and picked up by Itel's customers. (Pet. App. at 31a; Stip. ¶32). Itel's characterization of those depots as "independent contractors" holds no constitutional significance, because the use of those depots for delivery and pick up of Itel containers directly facilitated a substantial flow of business for Itel, and especially because the containers themselves were physically located in Tennessee. *Scripto, Inc. v. Carson*, 362 U.S. 207, 211 (1960). In addition, Itel was registered with the Sales and Use Tax Division of the Tennessee Department of Revenue as a dealer, and paid sales and use tax on other transactions based in Tennessee. (Pet. App. at 31a; Stip. ¶38). Finally, and most important, the activity assessed for tax in this case – the physical transfer of possession of the containers to Itel's customers – actually occurred in Tennessee.

Itel's physical presence in Tennessee, through its facilities, employees, and containers, establishes far greater nexus than was found to be sufficient in *Scripto*, 362 U.S. at 211 (a few "independent contractor" salesmen) or in *Standard Pressed Steel Co. v. Washington Dept. of Revenue*, 419 U.S. 560, 561 (1975) (one employee, a non-salesman engineering consultant). *See also National Geographic Society v. California Bd. of Equalization*, 430 U.S. 551 (1977). Itel's contacts with Tennessee therefore amply satisfy the bright-line substantial nexus rule of *Quill Corp. v. North Dakota*, No. 91-194, slip op. at 15 (U.S. May 26, 1992) and *National Bellas Hess, Inc. v. Dept. of Revenue*, 386 U.S. 753 (1967). *See also D.H. Holmes Co., Ltd. v. McNamara*, 486 U.S. 24, 32 (1988) ("nexus aplenty" where taxpayer has physical locations and economic presence in taxing state). Further, in the present case Tennessee had actual nexus with the transactions it seeks to tax, because those transactions, the transfers of possession of containers located in Tennessee, actually occurred in this state.

Despite the facts which establish Itel's actual presence in and thus nexus with Tennessee, it is argued that nexus did not exist because of the fiction that Itel's containers had no "legal presence" in Tennessee. (Brief of Institute of International Container Lessors, et al., at 27). Although 19 C.F.R. § 10.41a is cited as establishing that Itel's containers had no presence in Tennessee as a matter of law, nothing in that regulation supports such a legal fiction. Further, statements found in the *Xerox* and *McGoldrick* opinions to the effect that goods in customs-bonded warehouses are not subject to a state's taxing jurisdiction until withdrawn from the warehouses are

inapposite. As discussed above with regard to the preemption issue, there are drastic and congressionally-intended differences between the statutes and regulations pertaining to customs-bonded warehouses, and those excepting international cargo containers from the customs laws. Thus, the *Xerox* and *McGoldrick* opinions do not control here. Legal fictions devised in the context of customs-bonded warehouses do not also carry over to the subject of Itel's containers.

In any event, the crucial inquiry is not as to the extent and duration of Tennessee's nexus with the containers. Tennessee did not tax the containers. The question is whether Tennessee had sufficient nexus with Itel, and with Itel's business activities which gave rise to the tax. Itel was physically located in Tennessee, and conducted substantial business out of its Tennessee locations. The particular business transactions taxed in this case, the deliveries of containers to Itel's customers, actually occurred in Tennessee. The tax here beyond all doubt satisfies the nexus prong of *Complete Auto*.

Likewise, the second prong of the *Complete Auto* test is satisfied because Tennessee's sales tax is properly apportioned. The tax is consistent both internally and externally, as discussed above. Further, the tax reaches only those transactions in which delivery of the leased containers from Itel to its customers occurred in Tennessee; deliveries out-of-state or other Itel transactions based outside Tennessee are not taxed. Indeed, the trial court in this case struck down the assessment of tax on deliveries from Itel's Tennessee locations but consummated out-of-state. Therefore, the Tennessee sales tax is properly apportioned for purposes of the *Complete Auto* analysis. *Washington Stevedoring*, 435 U.S. at 746-47.

As to the third *Complete Auto* factor, the Tennessee sales tax is completely nondiscriminatory. The tax even-handedly applies to transfers of possession of tangible personal property for consideration occurring in Tennessee, and does not single out interstate or international business for any special burdens.

Itel's argument (Pet. Brief at 35-36) that Tennessee's tax system discriminates against foreign commerce is both unsupported by authority and patently incorrect. The Tennessee Supreme Court has recognized and held that the sales and use tax system is a uniform scheme designed to prevent avoidance of sales tax and ensure that Tennessee businesses do not suffer competitive disadvantage due to consumers purchasing goods out-of-state in order to avoid taxes. *Woods v. M.J. Kelley Co.*, 592 S.W.2d 567, 570 (Tenn.), *cert. denied*, 447 U.S. 905 (1980). Where an equivalent tax has been paid on a purchase outside Tennessee, the overall sales tax system does not require payment of use tax in Tennessee, because the customer's decision to buy out-of-state was presumably not determined by tax avoidance goals. The Tennessee Supreme Court has thus recognized that there is no legislative intent in Tennessee's sales tax statutes to levy more than one tax on a transaction, and that, for that very underlying reason, credits and adjustments are granted when equivalent tax has been paid to another jurisdiction. *Nasco, Inc. v. Jackson*, 748 S.W.2d 193, 196 (Tenn. 1988). Thus, even though Tenn. Code Ann. §§ 67-6-313(f) and 67-6-507(g) (Supp. 1991) refer to "states," the taxation policy of the Tennessee legislature as recognized by the Tennessee Supreme Court would allow similar credits and adjustments for equivalent taxes paid in another state or in another nation.

Finally, the fourth prong of *Complete Auto* is satisfied because Itel indisputably enjoys the benefits, protections, and services of Tennessee state and local governments. Itel's terminal and other facilities, its employees, and indeed its containers located in Tennessee all benefit from fire and police protection, and other civic services. The tax here is closely related to those benefits of an orderly society provided to Itel by Tennessee. *D.H. Holmes*, 486 U.S. at 32.

By satisfying the *Complete Auto* tests, and the other policy concerns identified in *Michelin*, the Tennessee sales tax readily passes constitutional muster under the Import-Export Clause.

B. The Tax Is Not A Direct Tax On Goods In Transit.

The *Michelin* Court apparently limited its holding by noting that the facts of that case involved only state taxation of goods "no longer in transit." *Michelin*, 423 U.S. at 302. However, this Court later concluded that the *Michelin* three-prong policy analysis should also determine Import-Export Clause questions where the goods are in transit, so long as the challenged state tax falls upon activities distinct from the goods and their value. *Washington Stevedoring*, 435 U.S. at 757.

As discussed above (pp. 15-18), the Tennessee sales tax is not an *ad valorem* tax, and is not a direct tax on the containers themselves. Instead, the sales tax is a privilege tax on persons engaging in certain types of business transactions. *Itel*, 814 S.W.2d at 38; *Hooten*, 209 S.W.2d at 274. Moreover, the containers carry imported goods, but are not themselves imported goods. Finally, the tax in this case was measured by the gross proceeds of the leases,

not the value of the containers. T.C.A. § 67-6-204. A rental price, including charges for related services, agreed upon by the parties to a lease is something quite distinct from the value of the leased item.

Itel's reliance upon *Louisiana Land and Exploration Co. v. Pilot Petroleum Corp.*, 900 F.2d 816 (5th Cir. 1990), *cert. denied.*, ___ U.S. ___, 111 S.Ct. 248 (1991), is misplaced. In *Louisiana Land*, the challenged Alabama tax was levied specifically on fuel, and was not a generally applicable sales tax such as the Tennessee tax in this case. *Id.*, 900 F.2d at 817n.1. Because the Alabama tax was aimed at a specific category of goods, it was susceptible of being used to create a protective tariff, in violation of the Import-Export Clause. *See Washington Stevedoring*, 435 U.S. at 753. Further, the incidence of the Alabama tax was on the consumer, unlike the Tennessee tax which is levied upon the seller. *Id.*, 900 F.2d at 818. Therefore, the Alabama tax was not a tax on the seller's business activities, but arguably constituted a direct tax on property purchased by the consumer. For those reasons, the tax in *Louisiana Land* is distinguishable from the sales tax in this case.

Regardless of whether goods are "in transit," the Import-Export Clause analysis of direct taxes employed in *Louisiana Land* does not apply when, as in the present case, the challenged tax is not a direct tax. *Washington Stevedoring*, 435 U.S. at 757. Instead, the Tennessee Supreme Court correctly applied the modern three-prong policy analysis of *Michelin*, 423 U.S. at 285-86, in upholding the tax against Itel's Import-Export Clause challenge. (Pet. App. at 17a).

CONCLUSION

For the reasons set forth above, the Commissioner of Revenue of the State of Tennessee respectfully submits that the decision of the Tennessee Supreme Court upholding the sales tax in this case was correct, and should be affirmed.

Respectfully submitted,

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APPENDIX

Tennessee Constitution,
Article 2, Section 28

In accordance with the following provisions, all property real, personal or mixed shall be subject to taxation, but the Legislature may except such as may be held by the State, by Counties, Cities or Towns, and used exclusively for public or corporation purposes, and such as may be held and used for purposes purely religious, charitable, scientific, literary or educational, and shall except the direct product of the soil in the hands of the producer, and his immediate vendee, and the entire amount of money deposited in an individual's personal or family checking or savings accounts. For purposes of taxation, property shall be classified into three classes, to wit: Real Property, Tangible Personal Property and Intangible Personal Property.

Real Property shall be classified into four (4) subclassifications and assessed as follows:

(a) Public Utility Property, to be assessed at fifty-five (55%) percent of its value;

(b) Industrial and Commercial Property, to be assessed at forty (40%) percent of its value;

(c) Residential Property, to be assessed at twenty-five (25%) percent of its value, provided that residential property containing two (2) or more rental units is hereby defined as industrial and commercial property; and

(d) Farm Property, to be assessed at twenty-five (25%) percent of its value.

House trailers, mobile homes, and all other similar movable structures used for commercial, industrial, or residential purposes shall be assessed as Real Property as an improvement to the land where located.

The Legislature shall provide tax relief to elderly low-income taxpayers through payments by the State to reimburse all or part of the taxes paid by such persons on owner-occupied residential property, but such reimbursement shall not be an obligation imposed, directly or indirectly, upon Counties, Cities or Towns; provided, that such tax relief for the years 1973 through 1977 shall be not less than an amount equal to the State, County, and Municipal Taxes on Five Thousand ($5,000) Dollars worth of the full market value (or One Thousand Two Hundred Fifty ($1,250) Dollars of the assessed value) of property used for a residence by any taxpayer over sixty-five (65) years of age for a period of one (1) year prior to the date of assessment; provided further, that such relief shall not extend to persons having a total annual income from all sources in excess of Four Thousand Eight Hundred ($4,800) Dollars.

The Legislature may provide tax relief to home owners totally and permanently disabled, irrespective of age, as provided herein for the elderly.

Tangible Personal Property shall be classified into three (3) subclassifications and assessed as follows:

(a) Public Utility Property, to be assessed at fifty-five (55%) percent of its value;

(b) Industrial and Commercial Property, to be assessed at thirty (30%) percent of its value; and

(c) All other Tangible Personal Property, to be assessed at five (5%) percent of its value; provided, however, that the Legislature shall exempt Seven Thousand Five Hundred ($7,500) Dollars worth of such Tangible Personal Property which shall cover personal household goods and furnishings, wearing apparel and other such tangible property in the hands of a taxpayer.

The Legislature shall have power to classify Intangible Personal Property into subclassifications and to establish a ratio of assessment to value in each class or subclass, and shall provide fair and equitable methods of apportionment of the value of same to this State for purposes of taxation. Banks, Insurance Companies, Loan and Investment Companies, Savings and Loan Associations, and all similar financial institutions, shall be assessed and taxed in such manner as the Legislature shall direct; provided that for the year 1973, or until such time as the Legislature may provide otherwise, the ratio of assessment to value of property presently taxed shall remain the same as provided by law for the year 1972; provided further that the taxes imposed upon such financial institutions, and paid by them, shall be in lieu of all taxes on the redeemable or cash value of all of their outstanding shares of capital stock, policies of insurance, customer savings and checking accounts, certificates of deposit, and certificates of investment, by whatever name called, including other intangible corporate property of such financial institutions.

The ratio of assessment to value of property in each class or subclass shall be equal and uniform throughout the State, the value and definition of property in each class or subclass to be ascertained in such manner as the

Legislature shall direct. Each respective taxing authority shall apply the same tax rate to all property within its jurisdiction.

The Legislature shall have power to tax merchants, peddlers, and privileges, in such manner as they may from time to time direct, and the Legislature may levy a gross receipts tax on merchants and businesses in lieu of ad valorem taxes on the inventories of merchandise held by such merchants and businesses for sale or exchange. The portion of a Merchant's Capital use in the purpose of merchandise sold by him to non-residents and sent beyond the State, shall not be taxed at a rate higher than the ad valorem tax on property. The Legislature shall have power to levy a tax upon incomes derived from stocks and bonds that are not taxed ad valorem.

This amendment shall take effect on the first day of January, 1973.

Tenn. Code Ann. § 67-5-2101

The taxes assessed by the state of Tennessee, a county, or municipality, taxing district, or other local governmental entity, upon any property of whatever kind, and all penalties, interest, and costs accruing thereon, shall become and remain a first lien upon such property from January 1 of the year for which such taxes are assessed.

Tenn. Code Ann. § 67-6-102(23)(A) (Supp. 1991)

"Sale" means any transfer of title or possession, or both, exchange, barter, lease or rental, conditional, or

otherwise, in any manner or by any means whatsoever of tangible personal property for a consideration, and includes the fabrication of tangible personal property for consumers who furnish, either directly or indirectly, the materials used in fabrication work, and the furnishing, repairing or serving for a consideration of any tangible personal property consumed on the premises of the person furnishing, preparing or serving such tangible personal property;

Tenn. Code Ann. § 67-6-201

It is declared to be the legislative intent that every person is exercising a taxable privilege who:

(1) Engages in the business of selling tangible personal property at retail in this state;

(2) Uses or consumes in this state any item or article of tangible personal property as defined in this chapter, irrespective of the ownership thereof or any tax immunity which may be enjoyed by the owner thereof;

(3) Is the recipient of any of the things or services taxable under this chapter;

(4) Rents or furnishes any of the things or services taxable under this chapter;

(5) Stores for use or consumption in this state any item or article of tangible personal property as defined in this chapter;

(6) Leases or rents such property, either as lessor or lessee, within the state of Tennessee;

(7) Charges admission, dues or fees taxable under this chapter; or

(8) Sells space under this chapter.

Tenn. Code Ann. § 67-6-202

For the exercise of the privilege of engaging in the business of selling tangible personal property at retail in this state, a tax is levied at the rate of five and one-half percent (5.5%) of the sales price of each item or article of tangible personal property when sold at retail in this state; the tax is to be computed on gross sales for the purpose of remitting the amount of tax due the state and is to include each and every retail sale.

Tenn. Code Ann. § 67-6-204(a)

(a) It is declared to be the intention of this chapter to impose a tax on the gross proceeds of all leases and rentals of tangible personal property in this state where the lease or rental is a part of the regularly established business, or the same is incidental or germane thereto. The tax is levied as follows:

(1) At the rate of five and one-half percent (5.5%) of the gross proceeds derived from the lease or rental of tangible personal property, as defined herein, where the lease or rental of such property is an established business, or part of an established business, or the same is incidental or germane to the business.

(2) At the rate of five and one-half percent (5.5%) of the monthly lease or rental price by lessee or renter, or

contracted or agreed to be paid by lessee or renter, to the owner of the tangible personal property.

Tenn. Code Ann. § 67-6-313(a)

(a) It is not the intention of this chapter to levy a tax upon articles of tangible personal property imported into this state or produced or manufactured in this state for export.

Tenn. Code Ann. § 67-6-313(f)

(f) In order to prevent actual multistate taxation of the acts and privileges subject to tax under this chapter, any taxpayer, upon proof acceptable to the commissioner being submitted that the taxpayer has properly paid sales and use tax in another state on such acts and privileges, shall be allowed a credit against the tax imposed by this chapter to the extent of the amount of such tax properly due and paid in another state.

Tenn. Code Ann. § 67-6-507(g) (Supp. 1991)

(g) In order to prevent actual multistate taxation of the acts and privileges subject to tax under this chapter, any taxpayer, upon proof acceptable to the commissioner being submitted that the taxpayer has properly paid tax on the privilege of sale or usage in another state on such acts and privileges, shall be allowed a credit against the tax imposed by this chapter to the extent of the amount of such tax properly due and paid in another state.

Tenn. Code Ann. § 67-6-517

(a) In the event any dealer fails to make a report and pay the tax as provided by this chapter, or in case any dealer makes a grossly incorrect report, or a report that is false or fraudulent, it shall be the duty of the commissioner to make an estimate for the taxable period of retail sales of such dealer, or of the gross proceeds for rentals or leases of tangible personal property by the dealer, estimating the cost price of all articles of tangible personal property imported by the dealer for use or consumption or distribution or storage to be used or consumed in this state, and assess and collect the tax and interest, plus penalty, if such have accrued, on the basis of such assessment, which shall be considered prima facie correct, and the burden to show the contrary shall rest upon the dealer.

(b) If any dealer subject to make and file a return required by any provision of this chapter fails to render such return within the time required or renders a return which is false or fraudulent in that it contains statements which differ from the true gross sales, purchases, leases, or rentals taxable under this chapter, or otherwise fails to comply with the provisions of this chapter for the taxable period for which the return is made, the commissioner shall give the dealer ten (10) days' notice in writing requiring the dealer to appear before him or his assistant with such books, records, and papers as he may require relating to the business of the dealer for such taxable period; and the commissioner may require the dealer or the agents and employees of such dealer to give testimony or to answer interrogatories under oath administered by the commissioner or his assistants respecting the

sale at retail, the use, consumption, or distribution, or storage for use or consumption in the state or lease or rental of tangible personal property subject to tax or the failure to make report thereof as provided in this chapter.

(c) If any dealer fails to make any such return or refuses to permit an examination of his books, records or papers, or to appear and answer questions within the scope of such investigation relating to the sale, use, consumption, distribution, storage, lease, or rental of tangible personal property, the commissioner is authorized to make an assessment based upon such information as may be available to him and to issue a distress warrant for the collection of any such taxes, interest or penalties found to be due. Any such assessment shall be deemed prima facie correct.

(d) In the event the dealer has imported the tangible personal property and he fails to produce an invoice showing the cost price of the articles as defined in this chapter, which are subject to tax, or the invoice does not reflect the true or actual cost price as defined herein, then the commissioner shall ascertain, in any manner feasible, the true cost price, and assess and collect the tax with interest plus penalties, if such have accrued on the true cost price as assessed by him; the assessment so made shall be considered prima facie correct, and the duty shall be on the dealer to show the contrary.

(e) In the case of the lease or rental of tangible personal property, if the consideration given or reported by the dealer does not, in the judgment of the commissioner, represent the true or actual consideration, then the commissioner is authorized to fix the same and collect the

tax thereon in the same manner as above provided, with interest plus penalties, if such have accrued.

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In the Supreme Court of the United States

OCTOBER TERM, 1992

ITEL CONTAINERS INTERNATIONAL CORPORATION,
PETITIONER

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE,
STATE OF TENNESSEE, RESPONDENT

On Writ of Certiorari to the Supreme Court of Tennessee

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REPLY BRIEF OF PETITIONER

Neither respondent nor its *amicus* offers any substantial reason to reject the positions advanced by Itel in its opening brief. The Solicitor General premises virtually all of his contentions relating both to the Conventions and to the Foreign Commerce Clause on the proposition that the nations of the European Community impose taxes on the transfer of containers. But this submission—which would require the Court to conclude that the United Kingdom and the 13 other nations that have protested Tennessee's tax do not understand the operation of their own tax laws (since our opening brief was filed, Belgium, Greece, and Portugal have joined in protesting the tax)—is insubstantial on its face. For its part, respondent does not deny that Tennessee is the *only* jurisdiction among the Convention signatories (and their political subdivisions) that taxes the transfer of containers. In these circumstances, the Tennessee tax cannot stand.

ARGUMENT

I. THE TENNESSEE TAX IS PREEMPTED

A. The Conventions Apply to Domestically Owned Containers

The United States begins its discussion of the Container Conventions with the wholly novel argument that the Conventions "are inapplicable to the domestic taxation of domestically owned containers." Br. 8. This contention was not considered by the court below, was not made by the Solicitor General at the certiorari stage, and is not endorsed by respondent; it accordingly cannot be interjected into the case by an *amicus* now. See, *e.g.*, *Kamen* v. *Kemper Financial Services, Inc.*, 111 S. Ct. 1711, 1716-1717 n.4 (1991). The argument is, in any event, without substance.[1]

[1] The Solicitor General takes issue with our submission that the 1956 Convention was implemented in the United States by statute

a. The Solicitor General's argument is hinged on Article 3(2) of the 1972 Convention. That article provides that each signatory nation "reserves the right not to grant temporary admission"—which is elsewhere defined to mean admission free of all duties and taxes—"to containers which have been the subject of purchase, hire-purchase, [or] lease * * * concluded by a person resident or established in its territory." But this language merely reserves to signatories the right to deny tax-free admission to containers that their residents *acquire* by lease or purchase outside the jurisdiction for use *in* the jurisdiction.[2] Nothing in the language otherwise alters the general requirement under the Conventions that "each Contracting Party shall grant temporary admission to containers, whether loaded with goods or not," when those containers are in use as instruments of international commerce. 1972 Convention Art. 3(1), 988 U.N.T.S. at 45. See 1956 Convention Art. 2, 20 U.S.T. at 304.

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and regulation. U.S. Br. 8. His argument is not correct. It is true, of course, that the United States exempted containers from the payment of Customs duty prior to its accession to the 1956 Convention. But federal law *was* changed "to implement the Conventions in respects not previously authorized under domestic law." Treas. Dec. 69-146 (referring to Pub. L. No. 90-635 (Oct. 24, 1968), which exempted repair components from duty). Similarly, the Treasury Department amended 19 C.F.R. 10.41a "in order to conform the Customs Regulations to * * * implement the * * * Customs Conventions." 34 Fed. Reg. 1951 (Feb. 11, 1969) (among other things, adopting the definition of the term "container" supplied by the Convention). The regulations cited by the Solicitor General (at Br. 10) state only that domestically-manufactured containers may be used in domestic commerce, and that payment of the duty frees foreign-origin containers for use in domestic commerce; they say absolutely nothing about the application of the Conventions to temporarily admitted containers that are not used in domestic commerce at all.

[2] While the term "lease" arguably is ambiguous in this regard (since both the lessor and the lessee "lease" the property), that is not true of the terms "purchase" and "hire-purchase," which describe only action taken by the acquiring party.

The Solicitor General's argument does violence to more than the language of the 1972 Convention; it also is inconsistent with both the 1972 Convention's background and the United States' longstanding interpretation of both Conventions. The second sentence of the 1956 Convention's Art. 2 (emphasis added), the predecessor of the 1972 Convention's Art. 3(2), provides that "[e]ach Contracting Party shall retain the right to withhold [temporary admission] in the case of containers which are *imported on purchase or otherwise taken into effective possession and control* by a person resident or established in its territory." The intent of this provision is plain: it was designed to subject containers to import duties upon their first entry into the taxing nation when they were obtained abroad and then brought into the jurisdiction as articles of trade, rather than as instrumentalities of international commerce.

In 1971, when the new draft Convention proposed including a slightly revised version of the 1956 Article 2, the United States objected, noting that "several Contracting Parties are applying this provision in such a way as to charge duty on containers purchased by resident operators upon first temporary importations"—that is, after they had become instrumentalities of international commerce. United Nations Doc. E/CONF. 59/16 at 2-3 (Nov. 26, 1971). The United States went on to explain that

> [t]he United States of America, *under both the [1956] Convention* and its internal regulations, allows duty free temporary importation upon first temporary entry *regardless of the residence of the owner.* Accordingly, the application of this provision by other contracting parties militates against purchase of US-made containers by operators resident in those countries.

Id. at 3 (emphasis added).

The next year the United States renewed its objection to Article 3(2). It explained:

> Acting under the provisions of the second sentence of article 2 of the 1956 Customs Convention, a provision

> carried forward as paragraph 2 in article 3 of the draft revised Convention, *some Contracting Parties charge duties and taxes on resident-owned foreign-built containers upon first importation even though they are in fact, being temporarily imported* * * *. *This approach appears to be inconsistent with the interest of the Convention.*

United Nations Doc. E/CONF. 59/C.2/L.7 at 4 (Nov. 15, 1972) (emphasis added). The provision nevertheless was included in the final version of the 1972 Convention.

There are several points to be taken from this history. First, the Solicitor General is wrong in asserting (at Br. 8-9) that resident-owned containers are exempted from United States Customs duty by statute and regulation rather than by the Conventions; more than 20 years ago the United States made clear that the exemption follows "under *both* the [1956] Convention and [the United States'] internal regulation." Second, as reflected in the comments of the United States, there were two competing interpretations of Article 3(2) and its 1956 predecessor—*neither* of which supports the Tennessee tax. Some countries, the United States explained, understood the provision to permit the taxation of "resident-owned foreign-built containers upon first importation," even if such containers were engaged in international trade at the time. The United States, in contrast, was of the view that the Conventions permit the taxation of containers only when they are imported for use in domestic commerce; the broader interpretation was rejected by the United States as, again, inconsistent with "both the Convention and [the United States'] internal regulations." And the broad view, even if correct, has absolutely no bearing here, since Tennessee is not suggesting that it is trying to tax the first importation (either by Itel or its lessees) of foreign-built containers.

At the same time, the Solicitor General's reading of Article 3(2) would render nugatory the provision's language about purchase, hire-purchase, lease, and the like.

Moreover, an interpretation that generally permits the taxation of all containers owned by domiciliaries of the taxing jurisdiction implicates the very concerns that underlay the United States' objection to Article 3(2): it would discourage the use of American-owned containers in favor of those owned by foreign domiciliaries.

b. It bears emphasis that preemption would be in order even if our reading of Article 3(2) were incorrect and the provision were intended to permit, in specified circumstances, the taxation of all containers owned (or sold or leased) by domestic sellers and lessors. Article 3(1) provides that each Contracting Party *shall grant* temporary admission to containers; article 3(2) then provides that "[e]ach Contracting Party *reserves the right* not to grant temporary admission" to specified containers. Plainly, these provisions confer tax immunity upon containers *unless* the signatory nation exercises its reserved right. Of course, the right is that of the Contracting Parties, not subnational units such as Tennessee. In this case, the United States has not exercised its reserved right either expressly or impliedly (the United States, after all, grants temporary admission to *all* containers engaged in foreign commerce, whatever the domicile of their owners (see 19 C.F.R. 10.41a(1)); the Solicitor General does not claim otherwise. The Tennessee tax accordingly cannot be reconciled with the plain terms of the Convention.[3]

c. Finally, the Solicitor General's insistence that the Conventions do not apply to domestic taxation of Itel's domestically owned containers is contrary to the history

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[3] *Maximov v. United States*, 373 U.S. 49, 52-56 (1963), cited by the United States at Br. 9, is simply off the point here. That case involved a bilateral convention intended to avoid duplicative taxation by reserving to each of the two contracting nations the right to impose a full measure of income tax upon its residents. It hardly stands for the proposition that international conventions invariably do not address how signatories will deal with their own residents. The other bilateral treaties cited by the United States at Br. 9 n.5 are similarly irrelevant.

and purposes of the Conventions. The signatories to the Customs Conventions did not contract merely to receive the reciprocal benefit of temporary admission in other countries. They sought, and now enjoy, the "significant economic benefits to the development and facilitation of international container traffic on a global basis" that follow from the tax-free movement of containers. U.N. Doc. E/CONF. 59/16 at 2 (Nov. 26, 1971). Indeed, President Johnson's stated purpose in recommending adoption of the 1956 Convention was to "aid the American export drive." See Pet. Br. 18. As a Contracting Party to the Conventions, the United States is obliged to participate in the "uniform facilitation of container traffic to the benefit of the international system." U.N. Doc. E/CONF. 59/IPG.2, Annex at 15 (First Meeting, Feb. 14-18, 1972).

B. The Tennessee Tax Is Inconsistent With the Uniform Practice of Convention Signatories

The United States' other principal argument concerning the Conventions—one that is not endorsed by respondent—is that the United Kingdom and the other EC countries themselves impose sales tax equivalents on containers. Neither the Solicitor General nor respondent deny that it would be highly relevant to the interpretation of the Conventions if other signatories withheld their taxes. Instead, the Solicitor General makes the remarkable assertion that the United Kingdom (and the other EC countries that have protested Tennessee's tax) misunderstand the operation of their own tax laws. Needless to say, this assertion is inherently implausible. Indeed, the United Kingdom has filed a diplomatic note with the State Department taking specific issue with the representations relating to British law made by the Solicitor General in his brief; the note reports that the government of the United Kingdom explained the operation of its tax laws to the United States and anticipated that "its response would put to rest any doubts that the U.K. does not tax the lease proceeds of containers dedicated to international trade * * *." Diplomatic Note, July 27, 1992 (a copy of the note is appended to this brief).[4] The United Kingdom is correct.

a. The Solicitor General erroneously equates a value added tax ("VAT") paid by an ultimate consumer of *goods* imported in a container with Tennessee's sales tax imposed directly *on* the container. The Solicitor General reasons that the "container lease is indirectly subjected to the VAT" (Br. 15 n.11) because the "value of imported goods is defined for purposes of the VAT * * * to include the price of the imported goods *plus* the cost of transport of those goods to the importing destination." Br. 14-15.[5] This argument confuses two entirely distinct concepts: the taxation of containers with the taxation of goods carried *by* container. Itel does not contend that for sales tax purposes Tennessee cannot include incidental transport costs (including the cost of container use) in calculating the value of goods sold in the state. In such circumstances it is irrelevant to the shipper, the vendor, and the ultimate taxpayer (the Tennessee consumer who ultimately purchases the goods at retail) that the cargo was transported in a container rather than by some other method.

But the Tennessee tax here does not merely factor in the contribution of the container in setting the value of goods transported *in* the container; it taxes the container

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[4] The Solicitor General addresses his argument only to tax laws of the EC nations. He rightly does not suggest that any other nation imposes a container tax. To give just two examples, Article 17(2)(ii) of the Cabinet Order promulgated under Japan's Consumption Tax Law exempts from tax "[t]ransactions involving the transfer or leasing of containers used for the transportation of freight mainly between domestic and foreign areas or between two foreign areas." (The translation is unofficial). And Canada exempts containers used in international commerce from its federal sales tax. See Excise Tax Act, R.S.C. 1985, § 213, Schedule VII.

[5] The Solicitor General's argument relies on Sixth Directive art. 11(B)(3)(b), which requires that the taxable value of imported goods include not only the price paid by the importer, but also other charges, "including 'incidental expenses, such as commission, packing, transport and insurance costs.'"

itself. The levy falls directly on the container lessor and lessee, adding an expense *because* the goods are being transported by container. Unlike the U.K. VAT paid by the ultimate consumer of goods shipped in a container,[6] Tennessee's sales tax imposed on the leased container directly discourages steamship lines from using containers in international trade, frustrating the very purpose of the Conventions—"remov[ing] impediments to the use of containers as 'instruments of international traffic.'" *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 453 (1979). By contrast, including the cost of container transport as a factor in valuing goods does not impose special disincentives on the use of containers as against other means of cargo shipment.

b. That the inclusion of transport costs in valuing the transported goods does not amount to a tax on containers within the meaning of the Conventions is dispositively confirmed by international practice relating to the calculation of Customs duties. The same valuation method employed for the VAT is authorized for Customs duty purposes by Article VII of the General Agreement on

[6] The Solicitor General's example of the imposition of the U.K.'s VAT upon goods carried in containers (see Br. 15 & n.11), is not supported by the record, commercial reality or the U.K.'s VAT statutes. A London importer will not itself lease a container in Tennessee. Itel and all container lessors lease containers to international steamship lines; exporters, importers and ultimate purchasers of the goods carried in containers are not container lessees. Stip. 71, Pet. App. 34a; Ex. 13; Tr. 38, 40-42, 60; Amicus Br. of the Institute of International Container Lessors, *et al.* at 2, 4-5; Amicus Br. of Pacific Merchant Shipping Association, *et al.* at 1, 9, 13; Amicus Br. of Asia North America Eastbound Rate Agreement, *et al.* at 4. Thus, the government's example at page 15 is inapposite. In addition, the Solicitor General incorrectly implies that the fictional London importer pays the VAT imposed on the value of the goods carried in the container. Because of the input/output tax aspect of the VAT regime, the importer does not pay any net VAT on the goods; the VAT only "adheres" to the ultimate consumer of the goods. O.J. European Comm. (No. L 145) art. 17(2)(a)(1977) (Sixth Directive 77/388); Value Added Tax Act 1983c 55 §§ 14, 15.

Tariffs and Trade (GATT);[7] indeed, the VAT on the importation of goods is "charged and payable as if it were a duty of customs." U.K. Value Added Tax Act 1983 (c 55), § 2(4). Pursuant to GATT Article VII, the United Kingdom and other signatories to both GATT and the Conventions include transportation costs in the dutiable value of imported goods. O.J. European Comm. (No. W34), art. 8, Council Regulation (EEC) No. 1224180. If the Solicitor General is correct in his argument that the VAT imposed on the ultimate consumer of imported goods really is a tax on the container lease (because the price of the goods includes a component representing transport costs), these GATT signatories impose prohibited Customs duties upon containers *every time* that they receive a shipment of goods in a container. Such an understanding, which would render the Conventions meaningless, cannot be correct.

c. It is plain moreover, that no EC VAT attaches to any temporarily-imported container *qua* container and that no EC transaction tax or ad valorem tax is paid or collected by the parties to container lease or sale transactions—and neither the Solicitor General nor respondent contends to the contrary. Thus, if the transactions that gave rise to the Tennessee tax had occurred in the EC, no VAT would have been paid upon the transfer of the container leases. Leases of transport equipment directly linked to the transit or export of goods are exempt from tax.[8] Similarly, a container leased by a U.K. shipping company exclusively for international transport from a lessor established outside the U.K. would

[7] Agreement on Implementation of Article VII of the GATT (GATT Customs Valuation Code), Pt. I, Article 8(2) provides that "[i]n framing its legislation, each Party shall provide for the inclusion in or the exclusion from the customs value, in whole or in part, of the following: (a) the cost of transport of the imported goods to the port or place of importation."

[8] Sixth Directive, art. 15(13); Regulation 50, Value Added Tax (General) Regulations 1985, S.I. 1985 No. 886 (a supply of a container for export is "zero rated").

bear no VAT; no VAT is charged on a supply from a foreign source when the same supply would not have been taxed if obtained from a U.K. supplier. See Value Added Tax Act 1983 (c.55) § 7; Regulation 50, *supra*, n.8. In addition, the container lease may be exempt from VAT if the container enters an EC country loaded with imported goods.[9] Finally, the UK and the other EC nations clearly exempt containers from the ad valorem VAT levied upon the importation of goods.[10]

d. The United States also notes that it and other nations impose taxes on the net income of container lessors and asserts that "[p]etitioner offers no explanation why *income* taxation applied to such containers is permitted

[9] Sixth Directive, art. 14(1)(i), provides that member states are required to exempt "the supply of services, in connection with the importation of goods where the value of such services is included in the taxable amount in accordance with Article 11B(3)(b)." The Solicitor General contends that this provision insures that container transfers "are subject to the VAT at least once." Br. at 17 (emphasis omitted). This is incorrect. The regulation "exempts" supplies of services (i.e., leases) "in connection with the importation of goods" while insuring that the importer includes the cost of the lease within the taxable value ultimately paid by the consumer upon the goods carried in the container under Art. 11B(3)(b). The Article 14(1)(i) exemption applies only to the lease of containers that are imported loaded; no VAT is paid or collected by a container lessor or lessee where a container is leased abroad and imported empty. In addition, a container leased within the UK for transit or export is exempted from the VAT under Art. 15(13), not 14(1)(i).

[10] Sixth Directive, art. 14(1)(c), provides that member states are required to exempt the "importation of goods declared to be under temporary importation arrangements, which thereby qualify for exemption from customs duties, or which would so qualify if they were imported from a third country." Itel's containers qualified for temporary admission under the Conventions. The United Kingdom implements this directive by waiving VAT on "containers which are temporarily imported for emptying or filling and subsequent re-exportation." HM Customs and Excise Notice 748, Concession B3 (Jan. 1, 1991).

but *revenue* taxation is not." Br. 14 (emphasis in original). In fact, the explanation is manifest in both the language and policy of the Conventions. As we explain in our opening brief (at 13-14), sales taxes are imposed "in connexion with" or "by reason of" importation because they are made possible by the container's entry into the taxing jurisdiction. That is not true of income taxes, which have nothing to do with whether any or all containers ever move into or leave the taxing nation.

At the same time, excepting container lessors from income taxes would lower shipping costs only in a very indirect sense (and would not do so at all if lessors failed to pass on the increased profits to lessees). In contrast, the taxation of individual container transactions—particularly in the form of a levy that, under Tennessee law, must be passed on to the container lessees—directly increases the cost of container transport. Indeed, the Court recognized precisely this distinction in a closely related setting involving federal income taxation of exporters:

> At most exportation is affected only indirectly and remotely [by an income tax]. The tax is levied after the exportation is completed, after all expenses are paid and losses adjusted, and after the recipient of the income is free to use it as he pleases.

William E. Peck & Co. v. Lowe, 247 U.S. 165, 175 (1918).

C. The Conventions Are Not Limited to the Proscription of Taxes That Discriminate Between Imports and Other Goods

The Solicitor General and respondent argue that Tennessee's sales tax is not imposed "in connexion with" or "by reason of" importation, contending that the Conventions proscribe only taxes that distinguish between goods of domestic and foreign origin. U.S. Br. 12-13; Resp. Br. 26. In support of this proposition the Solicitor General cites a list of wholly inapposite decisions involving, not the Conventions, but the Commerce and Import-Export Clauses. U.S. Br. 12. But the Conventions, of

course, make no such distinction. To the contrary, the 1972 Convention excepts from its proscription of taxes "fees and charges limited in amount to the approximate cost of services rendered." That exception plainly contemplates wharfage and user fees that do not depend upon the container's point of origin—and the exception's presence in the Convention makes clear that such generally applicable taxes are proscribed except when specially permitted.[11]

In addition, of course, any ambiguity here should be resolved by looking to the uniform understanding of Convention signatories. As the United Kingdom explains in its *amicus* brief, and as many of our trading partners explain in the diplomatic note submitted to the Department of State, Itel's reading of the Conventions' terms is generally shared by participants in the Conventions. Indeed, the views of the United Kingdom and of several of the other nations protesting Tennessee's tax (Belgium, France, Germany, Italy, the Netherlands, and Sweden) are due special deference in this regard because those nations constituted a majority of the Economic Commission for Europe Inland Transport Committee working party on containers, which prepared the 1956 Convention. UK Br. App. 1a, Ex. 21; UN Doc. E/ECE/TRANS/WP24/3 (Dec. 20, 1951).[12]

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[11] Indeed, in its brief to this Court in *Japan Line*—in which it argued that California's generally applicable property tax was preempted by the 1956 Convention—the United States noted that "'[f]ees that are related to the value of specific services provided to vessels and containers * * * are * * * permissibly charged under the custom of nations." No. 77-1378, U.S. Br. 15 n.7. The United States indicated that such fees include "wharfage fees and other similar user charges." *Id.* at 23 n.12. The exception to the 1972 Convention presumably was added to take account of this custom.

[12] Respondent (at Br. 27-31) cites the history of the 1956 Convention in arguing that it prohibits only traditional Customs duties. See also U.S. Br. 13 n.8. In addition to being flatly inconsistent with the language of both Conventions (see Pet. Br. 12-13), however, this argument runs up against the understanding of the nations involved in the creation of that history.

D. The Tennessee Tax Frustrates the Purpose of the Conventions

In our opening brief we explain that the Conventions were designed to facilitate the use of containers. Pet. Br. 17-21. We also note that state taxes on the transfer of containers, which add expense to the use of containers and therefore discourage container traffic, would frustrate that purpose; in *McGoldrick* and *Xerox* the Court held state taxes preempted in directly analogous circumstances. See Pet. Br. 21-27. Neither the Solicitor General nor respondent make any serious attempt to respond to those points.

To the contrary, while the Solicitor General acknowledges that "the scope of the preemption resulting from a customs bond must be determined by analysis of the 'congressional intent' in providing bonded admission" (Br. 20, quoting *Xerox*, 459 U.S. at 153), he never so much as hints at what the purpose of the Conventions (or of the Senate's intent in ratifying them) might be. In fact, that purpose is announced in the text of the Conventions and (notwithstanding the Solicitor General's assertion to the contrary at Br. 19) was stated by the Court in *Japan Line:* they "reflect[] a national policy to remove impediments to the use of containers." 441 U.S. at 453. The Solicitor General fails to explain why a state tax on the transfer of containers does not constitute such an impediment.

Curiously, the Solicitor General does assert that the "benefit conferred by the exemption 'from *federal* Customs duties' exists independently of the Tennessee tax and is not altered or reduced by that tax." Br. 19 (emphasis in original).[13] It certainly is true that Tennessee

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[13] The Solicitor General also appears to suggest that Itel did not benefit from the waiver of federal Customs duties during 1983-1986. U.S. Br. 18 n.14. Itel, of course, did not pay any Customs duties upon the importation of its containers because the containers were temporarily admitted into the United States under Customs bond as provided by the Conventions and 19 C.F.R. 10.41a. The Solicitor General contends that since Congress, beginning in 1983,

does not purport to impose or collect federal duties. Neither, however, did the States whose levies were challenged in *McGoldrick* and *Xerox*, where the Court invalidated state sales and property taxes precisely because the taxes imposed burdens of the type waived at the federal level by Congress. Those holdings are dispositive here.[14]

II. TENNESSEE'S TAX VIOLATES THE FOREIGN COMMERCE CLAUSE

The principles that govern application of the Foreign Commerce Clause are not in dispute. Neither the Solicitor General nor respondent takes issue with the proposition

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had temporarily suspended payment of duty on certain intermodal freight containers "having a gross mass rating of at least 40,000 pounds," Itel did not save any Customs duties by entering its containers under bond. The fact remains, though, that Congress waived the collection of Customs duties upon the importation of Itel's containers both to implement the protection provided by the Conventions and to accelerate implementation of international agreements reached by the United States through the Multilateral Trade Negotiations concluded in 1979. The Solicitor General's argument simply misses the point: absent explicit congressional action, the Tariff Schedules of the United States would have required Itel to pay duties of approximately $178,550; Tennessee's revised sales tax assessment of $158,012 substantially offsets that exemption. TSUS 640.30; Presidential Proclamation No. 4707 (Dec. 11, 1979, § A, Schedule 6, Part 2.

[14] For its part, respondent emphasizes a perceived difference between the pervasiveness of federal customs warehouse regulation on the one hand and container regulation on the other. Resp. Br. 34-35. While offering an extensive discussion of the customs warehouse regulations, however, respondent focuses its discussion of federal container regulation entirely on the statute authorizing Customs duty exemptions for instruments of international traffic, 19 U.S.C. § 1322(a); Tennessee simply ignores both the Conventions themselves and the substantial body of regulation administered by the Department of Treasury and the Customs Service, which is summarized in Itel's opening brief at 25 n.18. And while arguing that the Conventions and the bonded warehouse statutes serve different purposes (Resp. Br. 34-35), respondent fails to address the question whether the purposes served by the Conventions are frustrated by its tax. See Pet. Br. 24-25.

that a state tax must fall when it raises the prospect of retaliation from abroad by creating an asymmetry in international taxation. Both the Solicitor General and respondent also appear to recognize that (at least in some circumstances) the Commerce Clause precludes the imposition of state levies that raise a substantial risk of duplicative taxation. Application of these principles here is fatal to the Tennessee tax.

A. The Tennessee Tax Fails the "One Voice" Test

Respondent does not deny that the bulk of Itel's customers are steamship companies that are domiciled abroad. It nevertheless insists that "[n]o rational foreign government would retaliate against" the tax imposed upon Itel. Br. at 39. To support this surprising assertion, the State submits that Itel (and presumably the United Kingdom and the thirteen other nations that have protested the tax) "misunderstand[] the legal effect of Tennessee's tax" because the legal incidence of the levy falls upon the seller/lessor and "is not imposed on foreign nationals or foreign interests as such." Br. 38.

Simply put, this argument mischaracterizes the Tennessee tax. While respondent observes that "provision is made for Itel, if possible, to pass on the tax to its customers" (Br. 38), state law in fact *requires* that the tax be separately stated on the bill submitted to the lessee and that the tax be "collected by the retailer from the consumer insofar as it can be done." Tenn. Code Ann. 67-6-502. See Pet. Br. 37-38. And despite the State's "legal incidence" argument, the Tennessee courts have held that "the burden for the payment of the [sales] tax is meant to be that of the buyer." *Sam Carey Lumber Co. v. Sixty-One Cabinet Shop, Inc.*, 773 S.W.2d 252, 254-255 (Tenn. App. 1989). See *First Agricultural National Bank v. State Tax Commission*, 392 U.S. 339, 347 (1968) ("a sales tax which by its terms must be passed on to the purchaser imposes the legal incidence of the tax upon the purchaser"). Because the tax thus creates an asymmetry in international taxation that burdens foreign in-

terests—neither respondent nor the Solicitor General suggests that *any* foreign nation imposes taxes on American container lessees that relate to container transfers [15]—the Tennessee tax cannot stand. See *Japan Line*, 441 U.S. at 453.

For his part, the Solicitor General is now conspicuously silent regarding the prospect of foreign retaliation. In contrast, when he opposed Itel's petition for a writ of certiorari he contended that Itel's argument concerning the prospect of retaliatory taxation by other nations "lack[ed] any support" because he had not been advised by the Department of State that any "foreign government has protested, or threatened retaliation against, application of Tennessee's sales tax to transactions involving containers used exclusively in foreign commerce." U.S. Br. in Opp. 7 n.7. Since that time, of course, fourteen of our principal trading partners have objected to the Tennessee tax and the United Kingdom has informed the Court that it and other signatories to the Conventions "are not likely to tolerate a situation in which they refrain from imposing taxes while U.S. political subdivisions impose theirs." U.K. Br. 10-11. This places the prospect of retaliation—and thus the unconstitutionality of Tennessee's tax—beyond dispute.

B. The Tennessee Tax Raises the Prospect of Impermissible Multiple Taxation

As for the second element of the Foreign Commerce Clause test, the Solicitor General acknowledges that Tennessee's tax creates a real risk of multiple international taxation because "the United Kingdom and other European Community Nations may also apply their sales tax equivalent—or VAT—to the lease of the same containers." U.S. Br. 22-23.[16] He nevertheless insists that the bald risk of duplicative taxation does not suffice to invalidate a state tax on foreign commerce because, if it did, all state taxation of goods destined for export would be unconstitutional.

[15] While the Solicitor General of course contends that the values of container leases are taxed by the EC nations under their VATs, those taxes are paid by the ultimate purchasers of the goods carried in the containers, not by the container lessees (or lessors). In any event, as we explain above, the Solicitor General is simply incorrect in asserting that the EC nations do tax the transfer of containers. And because foreign container lessors are subject to the tax in Tennessee—as we noted in our opening brief (at 37 n.26) and as respondent does not deny—the state tax, even if borne entirely by the lessor, would for that reason create a risk of retaliation by creating an asymmetry in international taxation to the disadvantage of foreign nations, which do not tax sales or leases made abroad by American container lessors.

We agree with this statement, as far as it goes; we do not contend that foreign commerce should in all respects be immune from state taxation. Instead, we maintain only that state taxation is unconstitutional in those circumstances identified by the Court in *Container Corp.*, where it explained that the scrutiny "of double taxation in the foreign commerce context * * * must take into account the context in which the double taxation takes place and the reasonable alternatives available to the taxing State." 463 U.S. at 189. The Court explained further that the *Japan Line* tax had been invalidated because the State there "could [have] entirely eliminate[d] one important source of double taxation simply by adhering to one bright-line rule: do not tax, to any extent

[16] Somewhat inconsistently, the Solicitor General (at U.S. Br. 21-22)—as well as respondent (at Resp. Br. 19)—cite this Court's decision in *Wardair* for the proposition that sales taxes cannot pose the risk of multiple taxation. We explain in our opening brief (at 31-32) why *Wardair* stands for no such proposition; neither the Solicitor General nor respondent so much as addresses the points made in our opening brief. In addition, respondent's assertion that there can be no duplicative taxation here is belied by its own tax scheme: Tennessee itself recognizes the equivalence between its sales tax and compensating use taxes by providing a use tax credit for sales or use taxes paid to other States when *interstate* commerce is involved. Tenn. Code Ann. 67-6-313(f) (1989), -507 (1990). Of course, Tennessee does not provide a credit for equivalent *foreign* taxes. Tennessee's tax on foreign-commerce containers thus "discriminates against foreign commerce and therefore violates the Foreign Commerce Clause." *Kraft General Foods, Inc. v. Iowa Dept. of Revenue and Finance*, 60 U.S.L.W. 4582, 4585 (June 18, 1992).

whatsoever, cargo containers 'that are * * * used exclusively in international commerce * * *.'" 463 U.S. at 189-190, quoting *Japan Line*, 441 U.S. at 444. Requiring the State to adhere to this rule "was by no means unfair, because the rule did no more than reflect consistent international practice and express federal policy." *Id.* at 190.

The limiting principle found in the *Container Corp.* decision is equally applicable here. Requiring Tennessee to adhere to the same principle is by no means unfair or impractical: as we explain above, the rule reflects international practice and already is adhered to by all of Tennessee's sister States. Indeed, the Solicitor General advocates the same principle—that a potentially duplicative state tax is unconstitutional when it conflicts with consistent international practice (see U.S. Br. 23-24)—yet insists that there is no such conflict here. As we explain above, the Tennessee tax *does* collide with international practice; the tax therefore violates the Foreign Commerce Clause.

C. Sales Taxes May Violate the Foreign Commerce Clause

Respondent's remaining arguments lack substance. The State devotes considerable attention to distinguishing its sales tax from the property tax at issue in *Japan Line* (Br. 15-18); it does not, however, present any reason why the factual differences between sales and property taxes should have a legal significance under the Commerce Clause. Similarly, respondent's defense of its tax under the internal and external consistency tests (Resp. Br. 20-23) is beside the point. Those tests are used to apply the standard for taxation of *interstate* commerce announced in *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1977). The California tax invalidated in *Japan Line* also passed those tests; it nevertheless was invalidated because the taxation of foreign commerce must survive "a more extensive constitutional scrutiny." *Japan Line*, 441 U.S. at 446. The Tennessee tax cannot survive that scrutiny.

III. TENNESSEE'S TAX VIOLATES THE IMPORT-EXPORT CLAUSE

Neither the Solicitor General nor respondent takes issue with our statement of the governing law under the Import-Export Clause: they do not deny that direct taxes on in-transit exports violate the Clause and do not suggest that the Court's ruling in *Richfield* no longer is good law. Instead, they attempt to avoid application of the controlling law to the facts here. That attempt should be unavailing.

The Solicitor General simply restates the assertion that he made in opposing certiorari (and that the Court presumably considered and rejected when it granted review): that the Import-Export Clause is inapplicable here because "the goods the containers carry are exports, but the containers are not." U.S. Br. 27. This contention is insubstantial. The only authority offered by the Solicitor General for his assertion that containers are not exports, *Canton R. Co. v. Rogan*, 340 U.S. 511 (1951), is self-evidently beside the point. There, the Court upheld a gross-receipts tax on income that a railroad "derived from the *handling* of goods moving in foreign trade." *Id.* at 512 (emphasis added). The tax did not fall on any article that moved in foreign commerce; the tax instead was laid on income derived from services that the railroad provided in the form of switching, storage, wharfage, weighing and unloading. See *id.* at 512-513. Distinguishing *Richfield*, the Court explained that "[t]he difference is that in the present case the tax is not on the *goods* but on the *handling* of them." *Id.* at 514 (emphasis in original). Here, of course, the Tennessee sales tax does not fall upon the service of "hauling" goods, as the Solicitor General seems to suggest (at U.S. Br. 28), but instead is imposed directly on containers that are themselves articles in the stream of foreign commerce.

Indeed, as the Court explained in *Canton*, "[t]o export means to carry or send abroad; to import means to bring into the country." 340 U.S. at 515. Unlike services such as handling containers or the goods carried by container,

containers themselves (*like* the goods they carry) plainly are articles that are "sen[t] abroad" and "br[ought] into the country." *Ibid.* And there is no reason to believe that containers should be treated differently than other exports and imports under the Clause.[17]

For its part, respondent, while offering a lengthy rehearsal of the *Michelin* analysis (Resp. Br. 43-48), also does not assert that a state tax imposed directly on in-transit exports can survive Import-Export Clause scrutiny. Instead, it contends that its tax somehow "falls upon activities distinct from the goods and their value." *Id.* at 48. But the State's argument that its sales tax is a "privilege tax" rather than a "direct tax on the containers themselves" (*ibid.*) was rejected in *Richfield*, where the Court held that a State's characterization of its tax "is not determinative of the question whether the tax deprives the taxpayer of a federal right." 329 U.S. at 84. And respondent's claim that its sales tax is largely unrelated to the value of the underlying property is a nonsensical one that also has been rejected by the Court. "[T]he Court has always considered a tax on the sale of goods to be a tax on the goods themselves. * * * The sale ha[s] no value or significance apart from the goods." *Washington Stevedoring*, 435 U.S. at 756 n.21. Tennessee's tax, which falls directly on goods in transit, therefore violates the Import-Export Clause.

CONCLUSION

The decision of the Tennessee Supreme Court should be reversed.

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[17] In addition, the Solicitor General's position makes no logical sense. It cannot be dispositive that containers are used to facilitate the transport of other goods; the same is true of packaging materials, which inarguably may be imports or exports. Nor does it matter that the containers may return to this country; goods that are leased (rather than sold) for use across national borders are treated as imports or exports, even though they will return to the country of origin. And were it not for the Conventions, containers would be treated as imports for purposes of federal Customs duties. The Solicitor General offers no reason to believe that they should be treated differently for purposes of the Import-Export Clause.

Respectfully submitted,

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JULY 1992

APPENDIX

APPENDIX

Note No. 96

Her Britannic Majesty's Embassy presents its compliments to the Department of State and has the honour to refer to the brief for the United States as amicus curiae supporting the respondent in the US Supreme Court in ITEL Containers International Corporation v Joe Huddleston, Commissioner of Revenue of Tennessee.

Her Majesty's Government ("HMG") notes the references in the United States brief to the statements in the brief of the United Kingdom of Great Britain and Northern Ireland, as amicus curiae in support of the petitioner, relating to the applicability of value added tax (VAT) to leases of international commerce containers. The Department of State will recall that following a meeting held at the request of the Department of Justice, HMG provided written responses to a number of questions raised and an explanation as to the way in which the VAT system operates in the UK in the relevant area. A copy of this response is annexed to this Note. HMG believes that its description of UK domestic law should be accepted as authoritative and had expected that its response would put to rest any doubts that the UK does not tax the lease proceeds of containers dedicated to international trade under the 1956 Customs Convention on Containers (20 U.S.T. 301). HMG is surprised and disturbed that, notwithstanding this response, the United States Government ("USG") in its brief should inform the US Supreme Court that HMG's position on this point is "inaccurate and materially incomplete".

HMG would be grateful for a clarification of the position of the USG on this issue, and requests the State Department to draw to the attention of the US Supreme Court the contents of this Note and its annex, copies of which have been made available to the parties to the case.

Her Britannic Majesty's Embassy avails itself of this opportunity to renew the assurance of its highest consideration.

BRITISH EMBASSY

27 JULY 1992

1. This memorandum is being provided by Her Majesty's Government to the US Government at the request of the US Department of Justice which last week presented HMG representatives with a four-page paper stating that the portion of HMG's *amicus* brief regarding the applicability of the VAT to leases of international-commerce containers is incorrect and misleading to the Court. HMG appreciates the opportunity to comment on the DOJ's paper.

2. HMG wishes to inform the DOJ that it disagrees with the conclusion and the analysis set out in the DOJ paper. None of the representations made by HMG in its brief to the Court were lightly made. In particular, the VAT discussion at pages 8-9 is accurate, fair and continues to be the UK position. If the DOJ wishes to challenge before the Court the representations in the UK brief on how the UK VAT relates to containers leases, HMG requests that its responses herein be brought to the Court's attention as well.

3. The central point HMG makes in its discussion of the VAT in the brief is that ". . . HMG views the Convention as precluding the United Kingdom from imposing the 17.5% VAT in circumstances analogous to those under which Tennessee imposes its sales tax: on the leasing of containers dedicated to international commerce while those containers are in temporary import status in the United Kingdom under Convention rules". (UK Brief at 8). That is to say, when a shipping line leases an international-commerce container in the UK,[1] neither the containers lessor nor

[1] By "international-commerce containers in the UK," HMG of course means a container that (a) is dedicated to international commerce as prescribed in the Convention, and (b) is in the UK by reason of its importation under the temporary importation rules of the Convention.

the shipping-line lessee is burdened by the VAT; that result is dictated by the Convention's proscription of taxation on temporarily imported containers.

4. The result is no different when a shipping line leases an international-commerce container in Tennessee and that container, laden or empty, is temporarily imported into the UK. Again, neither the container lessor nor the shipping-line lessee is burdened by the VAT.

5. The VAT situation described in paragraphs 3 and 4 is also the case in the other EC member states as a result of the EC's principal VAT harmonisation directive, the Sixth Directive, which is wholly consistent with the 1956 and 1972 Conventions' prohibition of taxation on international-commerce containers.

6. The DOJ paper does not dispute the fact that unlike the Tennessee sales tax on the proceeds of an international-commerce container lease—which tax first burdens the container lessor but by law must be collected from the shipping-line lessee—the UK VAT burdens neither. Instead, in seeking to counter HMG's representation that the UK (in common with the major trading partners of the US[2]) does not impose any tax burdens on international-commerce container leases, the authors of the DOJ paper rely on the notion that the VAT *is* imposed on a container lease by virtue of the following[3]—

[2] In addition to the eleven nations that are party to the Diplomatic Note appended to the UK brief, HMG understands that three more nations have protested Tennessee's application of its sales tax to the lease of temporarily imported international-commerce containers: Belgium, Greece and Portugal.

[3] The example appearing in the first paragraph 2 of the DOJ paper does not comport with commercial reality. First, a London importer

(a) that a leased container may be used to carry imported goods into the UK;

(b) that the cost of transporting those goods to the UK will include an element attributable to the leased container cost;

(c) that the value of the goods on importation consists of the cost of the goods plus the transport costs;

(d) that the ultimate consumer of the goods in the UK (after all the intermediary steps of processing and distribution have been completed) will pay the market price for the goods inclusive of the VAT;[4]

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will not itself lease a container in Tennessee. The importer will engage a shipping line to transport the goods to the UK. It is that shipping line which almost invariably will lease the container in accordance with its container fleet requirements. The container lease cost will be one overhead cost incurred in the provision of the transport service offered by that shipping line and reflected in the price of that service, just as vessel costs, wages, stevedoring expenses, fuel costs, costs for inland tranport, and all other shipping line costs are reflected in the freight rate. Second, the $10,000 lease cost for a container leased for one trip from the US to the UK is wildly out of line. The actual lease cost for that one trip (putting aside the fact that a container is rarely leased for a single trip) will be much closer to $100 than $10,000. The hypothetical freight rate of $5,000 is also excessive but, even assuming that rate, it should include as a component part a container lease cost of about $100. The freight rate, then, would also include $5.50 in Tennessee tax on the lease proceeds. The balance of the freight rate ($4,894.50) would then represent all other costs of the shipping line, including a profit element, if any. In the text, HMG will assume these far more realistic circumstances.

[4] Because of the input tax/output tax aspect of the VAT regime, the importer and all intermediaries do not pay any net VAT on the goods; the VAT only "adheres" to the ultimate consumer of the goods since the consumer is not using them in a trade or business. Of course, if the goods are of a type that is relieved from the VAT (e.g., foodstuffs, children's clothing), even the ultimate consumer will not pay it.

(e) that since the price to the ultimate consumer will naturally reflect in some measure all costs in bringing the goods to market, including transport costs, the VAT applied to that price and collected from the consumer will include some tax on the transport and consequently some tax on every cost element that goes into the provision of the transport—the container lease cost being one such element.

From this, the DOJ paper suggests that HMG may have been less than candid with the the Court in stating that the UK and other signatories to the Convention do not tax the lease of containers dedicated to international trade. The suggestion, however, is not warranted.

7. The problem HMG and the other governments have with Tennessee's application of its sales tax to international container leases is that the tax imposes a burden on the use of international-commerce containers. The Convention was meant to facilitate the use of such containers and to prevent the imposition of tax and duty burdens. By assessing the tax on container lessors, to be collected from shipping-line lessees, Tennessee has increased the cost of international trading in contravention of the Convention since the tax is not subject to a credit elsewhere and is not otherwise refundable. The additional cost caused by the tax will be felt throughout worldwide trade. The tax applies no matter where a container is used and no matter what it carries (or, indeed, whether it carries anything). In short, the Tennessee tax is spread indiscriminately among all consumers buying goods transported in leased containers delivered in Tennessee.

8. HMG and the other governments *do not* complain that Tennessee applies its sales tax to goods imported

into the US and sold in Tennessee. The cost of such goods to the ultimate Tennessee consumer naturally includes an element attributable to the transport required to bring the goods from, say, the UK to Tennessee and, to the extent that the shipping line utilizes leased containers, container lease costs are of course a part of the transport element of the price paid by the consumer and taxed by Tennessee. However, taxation on the sale of imported goods is not the same as a tax on the lease of a temporarily imported container and is not therefore violative of the Convention. It is important not to confuse the taxation of imported *goods* with taxation on the supply of the *instrumentality* in which those goods were carried, the international-commerce container.

9. HMG should note at this point that the DOJ paper, in saying that the payment of the VAT by the ultimate consumer in the UK of goods imported into the UK is equivalent to a tax on container leasing, ignores the fact that a container leased in the UK is more likely to carry *exports*—as to which no VAT attaches of course—than imports, and that indeed the container will often be used in trading that involves neither UK exports or UK imports—again, as to which no VAT would attach. Even with respect to a container leased in Tennessee for a period of time exceeding the rare one-trip lease, the container will be used some of the time for purposes other than carrying imports to the UK. Moreover, containers are often temporarily imported into the UK without containing VAT taxable goods (the container might be transported empty because there is an imbalance in the ocean carrier's container fleet, it might contain VAT-exempt goods such as foodstuffs, or it might contain goods temporarily imported for re-exportation in the same or some other form). For these reasons alone, it cannot be said that imposition of the VAT

on the UK consumer of imported goods is the same as imposition of the VAT on the container lease itself. The two are entirely different concepts.

10. More imporantly, the DOJ paper misconstrues the provisions of the Sixth Directive dealing with valuation of imported goods (Article 11B) and similar provisions of the Value Added Tax Act 1983 (Section 11). These provisions essentially require that the value of imported goods at the point of importation must include both the price of the goods and the cost of getting them there. This is not a novel concept; the cost of transport is integral to the value of the goods. If it were not required to include transport costs in the value of imported merchandise, such merchandise would be unfairly and incorrectly priced to the detriment of domestic producers of like goods. The same valuation method is prescribed by Article VII of the General Agreement on Tariffs and Trade. Thus, the United States and all other GATT parties impose customs duty on the value so calculated, ie including transport costs. The purpose of the VAT valuation provisions cited in the DOJ paper is to ensure that the goods are valued correctly. Contrary to the assertion in the DOJ paper, those provisions are not designed to ensure that transport costs "are subject to the VAT at least once".

11. Focusing on customs duty helps make the position clear. As noted in the previous paragraph, the method for valuing imports (on importation) is the same for VAT purposes as for customs duty purposes—that is, the method requires the addition of transport costs (of which any container lease costs are a small part) to the price of the goods. Duty of course is paid on this confined amount, the accurate value of the goods. Customs duty is thus paid on the element of value represented by the transport,

including the container lease cost. If the authors of the DOJ paper were correct that the VAT imposed on the ultimate consumer of imported goods is the same as taxation of the container lease because the price of goods includes container hire as a component of transport cost, they would also have to say, in the customs duty context, that since duty is imposed on the transport cost, duty is also imposed on the container hire component of that cost. Such a position, while logically parallel to the DOJ position taken with respect to the VAT, would render the Convention meaningless. If one thing is incontrovertible it is that the Convention prohibits the imposition of customs duty on temporarily imported containers, including those on lease. But no one would assert that the US, the UK and all other signatories to the Convention impose duty on container leases despite the fact that the dutiable value of the goods includes container lease costs as part of the overall transport costs. Since that cannot be asserted in the customs context, neither should similar assertions be made in the parallel VAT context.

12. The analogy discussed in this paragraph and the next, in which aviation fuel costs are substituted for container lease costs as a component of transport costs, will again illustrate the basic error of the DOJ paper: confusion between a tax directly on a particular thing which is also a constituent element of a freight rate, on the one hand, and a tax on the sale of imported goods at the consumer level. Article 9 of the Air Services Agreement between the US and the UK (Bermuda 2) prohibits a party from imposing national sales or excise taxes on aviation fuel purchased by the other party's designated airlines for use in international air service operations. Practically all bilateral air services agreements contain equivalent provisions. Neither the US nor the UK impose any such tax on fuel; they each refrain from

imposing a national tax on aviation fuel because of their mutual obligations under their air services agreements.

13. Fuel is a principal cost component of the price for air freight service (much more so than container lease cost as a percentage of total ocean transport cost). When air cargo is flown from the US to the UK in a US commercial aircraft, for instance, its value for VAT and customs duty purposes includes the cost of transport, as it must in order to be economically sensible. As noted above, the VAT only adheres to the final purchaser of the imported goods, the consumer. Following the reasoning in the DOJ paper with regard to container leases, it would have to be concluded that, because the VAT on the *goods* is paid by the consumer, the UK and other EC countries in fact impose national taxes on *fuel* and thus violate their air services agreements innumerable times every single day. HMG is confident that the US Government would regard this reading as fanciful.

14. HMG trusts that this explanation will help clarify the issues raised.

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No. 91-321

In the Supreme Court of the United States

OCTOBER TERM, 1991

ITEL CONTAINERS INTERNATIONAL CORPORATION,
PETITIONER

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE OF
TENNESSEE

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF TENNESSEE

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING RESPONDENT

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QUESTION PRESENTED

The Tennessee Retailers' Sales Tax Act (Tenn. Code Ann. §§ 67-6-101 *et seq.* (1989 & Supp. 1991)) imposes a tax, at the rate of 5.5% of the transaction amount, upon the sale of "tangible personal property at retail in this state" (Tenn. Code Ann. § 67-6-201 (1989)). The statute defines a "sale" as "any transfer of title or possession, or both, exchange, barter, lease or rental * * * of tangible personal property for a consideration" (*id.* § 67-6-102(23)(A)).

The question presented is whether application of that Act to the lease of shipping containers, delivered at points within the State for use in international transportation of goods, is barred by the Commerce Clause (Art. I, § 8, Cl. 3) or the Import-Export Clause (Art. I, § 10, Cl. 2) of the Constitution of the United States or is preempted by the Customs Convention on Containers, May 18, 1956, 20 U.S.T. 301, T.I.A.S. No. 6634, 338 U.N.T.S. 103, acceded to by the United States effective March 3, 1969, or the Customs Convention on Containers, Dec. 2, 1972, S. Exec. Doc. X, 93d Cong., 1st Sess. (1973), 98 U.N.T.S. 43, acceded to by the United States effective May 12, 1985.

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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING RESPONDENT

INTEREST OF THE UNITED STATES

The United States is implicated directly in the questions presented in this case through petitioner's invocation of the Customs Conventions on Containers, to which the United States is a party. The United States also has an interest in matters before this Court involving foreign commerce that implicate the Import-Export Clause and the Commerce Clause of the Constitution. At the Court's invitation, the United States filed a brief *amicus curiae* at the petition stage of this case.

STATEMENT

1. Petitioner is a Delaware corporation with its principal place of business in San Francisco, California. It

is engaged in the business of leasing cargo containers [1] for international use. Petitioner purchases these containers abroad, where they were manufactured. Pursuant to 19 U.S.C. 1322(a) and regulations thereunder (19 C.F.R. 10.41a(a)(1), (c), (d), and (g), 113.66), the containers enter the United States duty-free as "instruments of international traffic," with a continuous bond given by petitioner guaranteeing payment of all duties, taxes, or liquidated damages that could be assessed for failure to comply with regulations regarding diversion or withdrawal of the containers from international commerce. Pet. App. 2a, 28a-30a.

Petitioner solicits leases for its containers through its offices located in numerous cities in the United States, but has no marketing office in Tennessee. The leases are on a per diem basis and restrict the use of containers to international commerce. Subject to that restriction, the lessee determines the route of travel and, to some extent, the period of use. Pet. App. 2a, 30a-31a, 34a.

Petitioner's containers are ordinarily leased at depots in Europe or the United States on an as-available basis under the standardized terms of a Master Interchange agreement. The written lease is normally executed after the container is delivered to the lessee. In some instances, petitioner permits shippers to pick up and load containers and transport them to a steamship line at an international port. In these situations, the steamship line then

[1] The Statement of Stipulated Facts filed by the parties in the Chancery Court describes these containers as follows (Pet. App. 28a) (numbering of sentences omitted): "Containers are specially manufactured steel boxes, 20 or 40 feet long, 8 feet wide and 8.5 or 9.5 feet tall. The containers are uniquely designed so that they may be used to transport goods by a variety of modes, including semi-trailer truck, rail car, or oceangoing vessel. The containers are secured to rolling stock while transported overland in international commerce. Because these containers are designed to be used in a variety of transportation modes, they are uniquely suited for use in international commerce."

enters into the lease agreement directly with petitioner. Pet. App. 32a-34a.

Prior to July 1, 1985, petitioner had no employees or terminals located in Tennessee. Instead, petitioner made arrangements for its containers to be delivered and picked up in that State at depots operated by other persons. Effective August 1, 1985, petitioner leased a tract of land and buildings in Memphis, Tennessee, where it thereafter maintained a terminal building and work station to receive, store, deliver, and, in some circumstances, repair containers.[2] Petitioner continued to allow customers to interchange containers at other depots in Tennessee, although it had no employees at those points. Pet. App. 2a, 31a.

2. Petitioner was audited by the Tennessee Department of Revenue for the period of January 1983 through November 1986. In December 1986, the Department issued an assessment determining that petitioner owed additional sales tax for the audit period. Petitioner paid the additional tax, penalty, and interest (in the amount of $382,465) and then filed a request for refund. After the refund was denied, petitioner brought this suit in state court. Pet. App. 19a, 24a, 34a-36a.

Upon consideration of the testimony and stipulated facts (Pet. App. 27a-37a), the trial court held, as a matter of state law, that the Tennessee Retailers' Sales Tax Act applies only to transactions in which possession of the containers is transferred to lessees in Tennessee and does not apply when lessees take possession outside of the State (*id.* at 20a-21a). The court therefore concluded that the state tax does not apply when the shipper

[2] Petitioner "collects and remits sales and use tax on fees which it collects for repair services rendered in Tennessee" (Pet. App. 2a-3a). The State's sales tax on repair services for containers was not challenged in this case (see *id.* at 3a). Nor does it appear that petitioner has challenged application of either federal or state income taxes that apply to the income petitioner receives from repairing or leasing containers.

loads the container and delivers it to the lessee outside of Tennessee at the port of exit (*ibid.*). Based upon that ruling, the court reduced the assessment of tax, penalty, and interest to $158,012 (*id.* at 24a-25a).

With respect to situations where transfer of possession to the lessee takes place in Tennessee, the court held that application of the State's sales tax is not unconstitutional (Pet. App. 21a). The court observed (*ibid.*) that, under the criteria of *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1977), businesses are not relieved of their just share of the State's tax burden simply because they are engaged in interstate commerce. The court concluded that the Commerce Clause does not require a different result in this case merely because the containers are used for international, rather than interstate, shipments (Pet. App. 21a-22a).

3. The State accepted the decision of the trial court and did not appeal. On petitioner's appeal, the Supreme Court of Tennessee affirmed the judgment of the trial court (Pet. App. 1a-18a). The court rejected petitioner's invocation of *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. 434 (1979), pointing out that (i) in this case, the owner and transferor of the leased containers is a domestic corporation, not a foreign corporation subject to tax in its own nation; and (ii) the tax involved in this case applies to a transaction that occurs within one nation only, so that the Tennessee statute does not impose multiple taxes on a single international transaction (Pet. App. 12a-14a). Because the state tax otherwise satisfies the tests established by *Complete Auto*, the court concluded that its imposition does not violate the Commerce Clause (Pet. App. 12a-16a).

The Tennessee Supreme Court also rejected petitioner's reliance on the Customs Convention on Containers. The court noted that the Convention exempts containers only from customs duties and other taxes imposed by reason of importation, and "Tennessee's sales tax is not a federal customs duty" (Pet. App. 13a). The Court

pointed out that bilateral tax treaties exempt only the "income derived by a *resident of a contracting state* * * * *from the* use, maintenance and *lease of containers* [used in international traffic] * * * from tax in the *other* contracting state" (Pet. App. 7a (quoting Convention for the Avoidance Of Double Taxation, Mar. 8, 1971, United States-Japan, 23 U.S.T. 967, 1084-1085, T.I.A.S. No. 7365)). Those treaty provisions manifest an understanding that income derived by domestic corporations from the "lease" of containers is *not* exempt from domestic taxation (Pet. App. 7a).

Finally, the court observed that the state tax is imposed on the proceeds of leases of shipping containers and "not [on] the value of the goods themselves" (Pet. App. 18a). The court therefore concluded that the state tax is not subject to challenge under the Import-Export Clause of the Constitution (Pet. App. 16a-18a).

SUMMARY OF ARGUMENT

I

The containers involved in this case are owned and leased by a corporation that is organized within, and a resident of, the United States. The Customs Conventions on Containers do not govern the domestic taxation of these domestically owned containers. Instead, petitioner's containers enter the United States under the provisions of 19 U.S.C. 1322(a), which protects them from the exaction of federal customs duties. The Tennessee Supreme Court correctly held (Pet. App. 13a) that the State's general sales tax is not a customs duty. Neither the statute nor the Conventions thus proscribe the State's tax.

Even if the Customs Conventions did apply to petitioner's containers, the Conventions do not restrict imposition of general sales taxes on container leases. Such taxes are not duties or taxes "chargeable by reason of importation" (Pet. App. 41a). They are therefore not within the scope of the Conventions' prohibitions. This

conclusion is manifest from the language and context of the Conventions. It is also evidenced by the practice of many Nations.

II

The Commerce Clause does not proscribe application of the State's general sales tax to container leases. There is no uniform international custom or practice of exempting container leases from the effect of generally applicable tax laws. To the contrary, the value of container leases is commonly subjected to income taxation, as well as value added taxation, among the Nations that are signatories to the Customs Convention. The State's tax thus does not interfere with an accepted international practice in a manner that impedes our Nation's ability to speak with one voice on matters concerning foreign commerce.

In *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. 434 (1979), the California property tax on foreign-owned containers conflicted with the internationally accepted "home port" rule governing property taxation of instruments of international traffic. By contrast, the Tennessee sales tax on leases of domestically owned containers is both *consistent* with the "home port" rule and not inconsistent with any other international practice. Any potential multiple taxation that may result when other Nations impose similar sales or use or VAT taxes on these same transactions—but do not follow our domestic practice of providing a credit for the prior tax paid—cannot make the Tennessee tax unconstitutional. In this context, the neutral Tennessee tax cannot be said to be responsible for the potential multiple tax that could result from differing, rather than consistent, international practices. The States are not required by the Commerce Clause to serve as the equilibrator of all worldwide tax burdens.

III

The Tennessee sales tax is not prohibited by the Import-Export Clause. A tax on container leases "is not on the *goods* but on the *handling* of them" (*Canton R.R.*

v. *Rogan*, 340 U.S. 511, 514 (1951)). The Import-Export Clause prohibits the States from imposing customs duties on goods; it does not apply to generally applicable taxes imposed on "hauling them to or from distant points" (*id.* at 515).

ARGUMENT

I. THE CUSTOMS CONVENTIONS ON CONTAINERS DO NOT PROSCRIBE A TAX ON THE LEASE OF CONTAINERS

The Customs Conventions on Containers provide for the "temporary admission" of containers "free of import duties and taxes and free of import prohibitions and restrictions" (Pet. App. 39a, 42a). The phrase "import duties and taxes" is defined by the 1972 Convention to mean customs duties and taxes "collected on, or in connexion with, the importation of goods" (*id.* at 39a) and by the 1956 Convention to mean "all duties and taxes whatsoever chargeable by reason of importation" (*id.* at 41a).

The Tennessee Supreme Court correctly concluded that the Conventions do not proscribe application of the State's general sales tax to the lease of containers. This conclusion is supported not only by the plain and limited language of the Conventions, but also by the practice of the signatory parties. As we discuss at pp. 11-17, *infra*, contrary to petitioner's submission, the practice of many signatory Nations is to apply their general tax provisions to the value of the lease of containers used in international traffic. As we discuss first, however, the Conventions do not apply *at all* to the domestic taxation of domestically owned containers, and petitioner's invocation of the Conventions to proscribe taxation by governmental units in its own Nation is thus entirely misplaced.

1. *The Customs Conventions On Containers Are Inapplicable To The Domestic Taxation of Domestically Owned Containers*

Petitioner misunderstands the genesis and scope of 19 U.S.C. 1322(a) and the manner in which that statute interrelates with the Customs Conventions on Containers. Petitioner erroneously states that, "[a]fter its ratification, the 1956 Convention was implemented in the United States by Treasury Department regulations designating containers 'instruments of international traffic' (19 C.F.R. 10.41a(a)(1)) and by a statute excepting such instruments from application of the Customs laws. 19 U.S.C. 1322(a)" (Pet. Br. 18). Petitioner's chronology, and its understanding of the scope of these provisions, are flawed.

The 1956 Customs Convention on Containers was not acceded to by the United States until 1969. See 20 U.S.T. 333 (1969). 19 U.S.C. 1322(a) was adopted years prior to, and independently of, the Convention. The statute was enacted in 1953 to allow citizens of all Nations (including United States citizens) to obtain temporary admission of "instruments of international traffic" (*ibid.*) free "from the application of the customs laws" of this country (*ibid.*).[3] It authorizes the Secretary of the Treasury to adopt regulations designating the "instruments of international traffic" for which temporary admission is allowed. *Ibid.* Pursuant to this authority, the Secretary adopted 19 C.F.R. 10.41a(a)(1) in 1960, designating various types of "cargo vans" as "instruments of international traffic" subject to temporary admission without "payment of [customs] duty" (*ibid.*). It is pursuant to this statute and regulations—not pursuant to the Customs Conventions on Containers—that petitioner's foreign-manufactured containers have

[3] 19 U.S.C. 1322(a) was enacted as Section 14 of the Customs Simplification Act of 1953, ch. 397, 67 Stat. 516. Reciting developments in containerization practices in the shipment of merchandise, 19 C.F.R. 10.41a was adopted by T.D. 55,078, 25 Fed. Reg. 2530 (1960).

been "temporarily" admitted duty-free into the United States.

The Customs Conventions are designed to secure for domestically owned containers abroad the same temporary, duty-free admission that the United States provides for "instruments of international traffic" under 19 U.S.C. 1322(a).[4] As is customary with international agreements, however, the Conventions do not purport to dictate to each Nation how it will treat *its own citizens*. See *Maximov* v. *United States*, 373 U.S. 49, 52-56 (1963).[5] Thus, while the Conventions generally provide that "each Contracting Party shall grant temporary admission to containers" (Pet. App. 40a; see *id.* at 42a)), they further provide that (*id.* at 40a; see *id.* at 42a):

> Each Contracting Party reserves the right not to grant temporary admission to containers which have been the subject of purchase, hire-purchase, lease or a contract of a similar nature, concluded by a person resident or established in its territory.

[4] The 1972 Convention seeks to "insure United States-owned containers the same treatment in the territories of States parties to this Convention as that afforded in the United States to foreign-owned containers." S. Exec. Doc. X, 93d Cong., 1st Sess. iii (1973).

[5] In *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. at 446 n.10, this Court noted that, in a bilateral tax convention between Japan and the United States, it was agreed that income derived by a resident of a Contracting State from the use and lease of containers and related equipment is exempt from tax in the *other* Contracting State. Similar agreements are set forth in, or in connection with, conventions for the avoidance of double taxation with the Netherlands Antilles (Art. 8, para. 3, 2 CCH Tax Treaties at 37,011-37,012), with Norway (Dec. 3, 1971, United States-Kingdom of Norway, Exchange of Notes, para. 1, 23 U.S.T. 2832, T.I.A.S. No. 7474), and with the United Kingdom (Apr. 13, 1976, United States-United Kingdom-Northern Ireland, Exchange of Notes, para. 4, 31 U.S.T. 5668, T.I.A.S. No. 9682). Neither the Customs Conventions on Containers, nor the conventions for avoidance of double taxation, impose an obligation upon a contracting party to refrain from imposing taxes with respect to its own residents. See *Maximov* v. *United States*, 373 U.S. at 52-56.

Since petitioner is "established" within, and a "resident" of, the territory of the United States, the status of its containers within the United States is determined independently of the Customs Conventions—under 19 U.S.C. 1322(a). The Conventions impose no obligation upon the United States, or on any State of the United States, with respect to domestically owned containers. See also note 5, *supra*.

This express limitation on the scope of the Customs Conventions is reflected in other regulatory provisions. If petitioner had purchased containers of domestic manufacture, there would have been, of course, no restriction on their use in domestic commerce. Pursuant to 19 C.F.R. 10.7(a), their movements in and out of the country would have been governed by "the general regulations governing the free entry of domestic products exported and returned" (*ibid.*). Having purchased containers "of foreign production," if petitioner had "imported [them] duty paid," they would thereafter be available for domestic commerce and would also be exempt from duty for exit and re-entry upon compliance with the formalities set forth in 19 C.F.R. 10.7(b) through (f).

As permitted by 19 U.S.C. 1322(a) and 19 C.F.R. 10.41a, however, petitioner chose to avoid paying duty on its containers of foreign origin by applying for release of those containers and filing the bond conditioned upon devoting the containers solely to international traffic pursuant to 19 C.F.R. 113.66. It is these statutory and regulatory provisions, not the Customs Conventions on Containers, that govern the treatment of domestically owned containers by the United States.

The command of Congress in 19 U.S.C. 1322(a) is quite specific and limited. It is to except designated instruments of international traffic

> from the application of the customs laws to such extent and subject to such terms and conditions as may be prescribed in regulations or instructions of the Secretary.

Ibid. In designating containers as instruments of international traffic, the Secretary provided only that they may be temporarily admitted without "the payment of [customs] duty" (19 C.F.R. 10.41a(a)(1)). No other state or federal taxes are proscribed by the Secretary's regulations or by 19 U.S.C. 1322(a).

The Tennessee Supreme Court correctly observed that the State's general "sales tax is not a federal customs duty" (Pet. App. 13a). See *Michelin Tire Corp.* v. *Wages*, 423 U.S. 276, 290-294 (1976). If it were a customs duty, it would violate the Import-Export Clause of the Constitution (see *ibid.*), as well as 19 U.S.C. 1322(a). Not being a customs duty, however, the state tax violates neither.[6]

2. *The Customs Conventions Do Not Proscribe Application Of General Sales Taxes To The Leasing Of Containers*

Failing to recognize that the Customs Conventions do not apply to the taxation of domestically owned containers, petitioner asserts (Pet. Br. 12-21) that the Conventions should be interpreted to proscribe application of general sales taxes to the leasing of containers. That contention is also incorrect.

a. To determine the scope of the Conventions, it is, of course, appropriate first to look to their language. See *Air France* v. *Saks*, 470 U.S. 392, 397 (1985); *Maximov* v. *United States*, 373 U.S. at 52. The limitations of the Conventions' undertakings are expressed in plain and simple terms. When applicable, the Conventions proscribe assessment of customs duties and all other taxes

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[6] Petitioner appears to acknowledge that "19 U.S.C. 1322(a) excepts instrumentalities of foreign commerce only from the Customs laws" (Pet. Br. 26 n.19). Petitioner's reliance on the notion that a statute preempting customs "duties" also preempts general state sales taxes (*ibid.*) is discussed at pages 17-21, *infra*. We note here only the significant overbreadth of such a contention, for many goods are admitted duty-free and are unquestionably not thereby made immune from general sales tax.

"collected on, or in connexion with, the importation of goods" (Pet. App. 39a) or "chargeable by reason of importation" (Pet. App. 41a). Petitioner contends (Pet. Br. 12-13) that a state sales tax on container leases is "chargeable by reason of importation" because the container is present, and available for lease, in the United States due to its importation. That contention is fundamentally misconceived.

It is not the *presence* of the container, but the *duty* or *tax* that must be "chargeable by reason of importation." The State's general sales tax on container leases is indifferent as to whether the containers are in Tennessee "by *reason* of importation" or otherwise. The tax is imposed upon the proceeds of "any transfer of title or possession, or both, exchange, barter, lease or rental * * * of tangible personal property for a consideration." Tenn. Code Ann. § 67-6-102(23)(A) (1989). Whether the property subject to the State's tax is of domestic or foreign origin has no bearing on imposition of the tax. See *ibid.*; *Washington Revenue Dep't* v. *Stevedoring Ass'n*, 435 U.S. 734 (1978) (upholding application of the State's gross receipts tax to the loading and unloading of cargo ships engaged in foreign and domestic commerce); *Hinson* v. *Lott*, 75 U.S. 148, 153 (1869).

The proscription in the Conventions of duties and other taxes "chargeable by reason of importation" is designed to capture customs or importation charges travelling under any name, but "chargeable by reason of importation." What is known as a "customs duty" in English may be described by some entirely different name or concept in the usage of other Nations: the Convention thus identifies its subject as "not only Customs duties but also all duties and taxes whatsover chargeable by reason of importation" (Pet. App. 41a).[7] By thus broadly identifying the particular subject of the Conventions, the language does not *alter* the subject of the Conventions.[8]

[7] Another example of a tax "chargeable by reason of importation" that departs from the ordinary mold of a "customs duty" was considered by this Court in *Brown* v. *Maryland*, 25 U.S. (12 Wheat.) 419 (1827). That case concerned a state license tax that applied only to persons selling "foreign articles or commodities." *Id.* at 436. The state tax did not also apply to persons selling domestic articles. The Court thus concluded that the tax was imposed solely by reason of importation and was proscribed by the Import-Export Clause. *Id.* at 439-443. See *Michelin Tire Corp.* v. *Wages*, 423 U.S. at 294-298.

The general sales tax applied by Tennessee does not differ in its treatment of domestic and foreign goods. It thus cannot be said to be "chargeable by reason of" or "in connection with" importation. The present case is similar, in this regard, to *Hinson* v. *Lott*, 75 U.S. at 153, where the Court held that a state sales tax on imported liquors did not violate the Commerce Clause because an equivalent state tax was imposed on the manufacture of liquors within the State. See also *Kraft General Foods, Inc.* v. *Iowa Department of Revenue and Finance*, No. 90-1918 (June 18, 1992), slip. op. 7.

[8] That the focus of the Conventions is on customs duties, and not upon internal taxes imposed without reference to the origin of the goods involved, is indicated not only by the narrow language employed by the Conventions but also by their Protocol of Signature. Each convention provides that the Protocol of Signature is an integral part of the convention. Para. 22, 20 U.S.T. 312; Para. 17, 988 U.N.T.S. 47. The Protocol of Signature provides: "The terms of the present Convention shall not preclude the application of national provisions or of internal agreements not of a Customs nature, regulating the use of containers." Para. 2, 988 U.N.T.S. 74. See Para. 2, 20 U.S.T. 326.

b. Petitioner states (Pet. Br. 12) that, so far as it has been able to determine, no signatory of the Conventions nor any political subdivision of any signatory (other than Tennessee) has imposed a sales tax, or other similar tax, on the lease of containers. That petitioner found its inquiry to be fruitless does not establish that there are no fruits.

Petitioner's claim that container leases are not subject to tax in other jurisdictions is incorrect. The income that petitioner derives from the lease or sale of its containers is subject to the federal income tax (26 U.S.C. 11, 61) and to state income taxes (see *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425, 448 (1980) ("[c]oncurrent federal and state taxation of income, of course, is a well-established norm"). The income derived by foreign owners of containers is also subject to tax abroad.

See note 5, *supra*. Petitioner offers no explanation why *income* taxation applied to such containers is permitted but *revenue* taxation is not.

Petitioner instead contends (Pet. Br. 15 & n.13) that Tennessee should not be allowed to impose its sales tax because various foreign nations have exempted transactions involving containers engaged in international commerce from their value added tax (VAT), which is their domestic analogue to the State's sales tax.[9] Petitioner and its amicus (United Kingdom Amicus Br. 9) suggest that the United Kingdom (UK) and other European Community (EC) Nations "refrain from imposing * * * VAT or similar taxes on international container leases" (*ibid.*). That contention is inaccurate and materially incomplete.

Under the EC Sixth Directive, and under the UK Value Added Tax Act of 1983 (on which petitioner and amicus rely), a VAT is applied in two basic situations: (i) when goods or services are supplied within the taxing jurisdiction, a VAT on the value of those goods or services is paid by the supplier; (ii) when goods are imported, a VAT on the value of imported goods is imposed on the importer.[10] The value of imported goods is defined for

[9] The basic characteristics of value added taxes are discussed in *Trinova Corp.* v. *Michigan Dep't of Treasury*, 111 S. Ct. 818, 823-824 (1991). The United Kingdom and other EC Nations apply the "credit" method of value added taxation. See *Treasury Department Report To The President: Tax Reform For Fairness, Simplicity, And Economic Growth, Vol. 3, Value Added Tax* 8 (1984):

> The credit, or invoice, method is used by all of the member countries in the European Economic Community (EEC) and by most other countries that have a value-added tax. Under the credit method, a firm's tax liability is determined by allowing the firm to subtract value-added tax paid on purchases from tax due on its sales.
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> * * * [A]ny value added tax evaded by firms prior to the retail level would result in higher taxes at the retail level; lower tax rates at pre-retail stages would be offset by full collection of the tax at the retail level.

[10] See EC Sixth Directive, Art. 2(1) and (2); UK Value Added Tax of 1983, Art. 1. The EC Sixth Directive is reproduced at CCH

purposes of the VAT—under both the EC Sixth Directive (Art. 11B(3)(b)) and the UK Value Added Tax Act of 1983 (Art. 11(2)(b))—to include the price of the imported goods *plus* the cost of transport of those goods to the importing destination.

For example, if a London importer purchases goods at a price of $100,000 in Tennessee, leases containers in Tennessee from ITEL for $2,000 for the purpose of shipping those goods to London, and also pays a freighter $1,000 to load the containers in Tennessee and transport them to London, the UK VAT will be applied at its ordinary rate (15%) to the total sum of $103,000. It is thus incorrect to say—as petitioner and amicus have said (Pet. Br. 15 & n.13; UK Amicus Br. 8, 9)—that the UK and other EC Nations do not impose a VAT on the value of "international container leases," for the value of such leases is included in the cost of transport to which the VAT on imported goods applies.[11]

In support of the contention that the UK has "relieved [international containers] from the VAT" (UK Amicus Br. 8), the UK Brief cites various provisions of the EC Sixth Directive and of the UK Value Added Tax Act of 1983 that concern the separate VAT applicable to the "supply of goods and services" within the taxing jurisdiction. The provisions that the UK Brief cites do not restrict, but rather complement, the VAT on imported goods.

In particular, Art. 14(1)(i) of the EC Sixth Directive, on which petitioner and amicus rely, contains a telling

Common Mkt. Rep. 3507. The UK Value Added Tax Act of 1983 is reproduced at 48 *Halsbury's Statutes of England and Wales* 598 (4th ed. 1988).

[11] Alternatively, if the importer purchases $100,000 of goods in Tennessee and engages a shipping company to arrange the transport of the goods to London, and the cost of the shipment (including the allocated cost of the container lease) is $3,000, the VAT will apply to the same total of $103,000. The container lease is indirectly subjected to the VAT in this situation, but the effect of the tax is the same. See note 13, *infra*.

cross-reference (which petitioner and amicus fail to mention or address) to the tax on imported goods.[12] Article 14(1)(i) provides that "the supply of services, in connection with the importation of goods" shall not be subject to the VAT, *but only "where the value of such services is included in the taxable amount in accordance with Article 11B(3)(b)"* (*ibid.*) (emphasis added). Article 11B(3)(b), which is cross-referenced in Article 14(1)(i), is the provision that specifies that the VAT on imported goods "shall include" not only the price of the imported goods but also "incidental expenses, such as * * * transport * * * incurred up to the first place of destination." Thus, the effect of Article 14 is not to *exempt* international transport services from the VAT, as petitioner and its amicus erroneously state, but is to provide that, *when* such services are captured in the VAT on imported goods,

[12] The other provisions of the EC Sixth Directive that are cited in the UK brief are simply off the point, for they relate to the fact that goods supplied for export, and services provided to such goods, are not subject to the VAT because, once exported, any VAT paid will be credited back to the supplier. Such goods and services do not escape VAT taxation; the VAT on such goods and services is collected by the importing Nation. See EC Sixth Directive, Arts. 2(2), 11B(3)(b); UK Value Added Tax Act of 1983, Arts. 1, 11(2)(b).

The various sources cited in footnote 14 of the UK Brief also are irrelevant, both for this reason and also because they are designed to limit the broad statement in Article 6(5) of the 1983 Act that any supply of services is treated as supplied in the UK, and is thus subject to the UK VAT, "if the supplier belongs in the United Kingdom". Schedule 5, Group 10, Item 11 of the Value Added Tax narrows this broad proposition by providing that such services will *not* be treated as supplied in the UK, even when provided by a UK supplier, if they involve the "supply of services performed outside the United Kingdom, which are ancillary to the transport of goods." These provisions relate specifically to calculating the VAT on the *supply* of goods and services (see UK Value Added Tax Act of 1983, Art. 16); they do not affect calculation of the separate VAT imposed on the importation of goods. As discussed above, the VAT on imported goods specifically includes the cost of transport of the goods, including the cost of container leases in connection with such transport.

they are not subjected to an *additional* VAT as a "supply of goods and services." Far from exempting international transport services, the EC Sixth Directive and the UK Value Added Tax Act of 1983 are designed to insure that *they are subject to the VAT at least once.* See also note 9, *supra.*

To the extent that the practice of Nations informs interpretation of the Customs Conventions, as petitioner contends (Pet. Br. 15-17), it is evident that the practice of the UK and other EC Nations is to tax the value of transportation services provided by containers, including the leasing of such containers. The UK and EC practice, if relevant, thus *supports* the conclusion that the Tennessee tax on container leases is not precluded by the Conventions. If the Tennessee tax *is* precluded by the Conventions, then so too would be the UK VAT applied to similar leasing charges in connection with its VAT on imported goods.[13]

[13] The UK tax is not distinguishable from the Tennessee tax on the grounds that, while the VAT system of taxation allows the provider of goods and services and the importer a credit against the VAT owed for prior VAT taxes paid, the VAT does *not* allow such a credit for non-VAT taxes (such as the Tennessee sales tax) (see note 9, *supra*). It is purely a matter of domestic policy for the UK *not* to give such a credit for the Tennessee tax. Whether or not the UK or other EC Nations wish to give a credit for this tax has nothing to do with the Customs Conventions on Containers, which hardly can be regarded as adopting and imposing on all signatories an international VAT system of taxation.

Nor does the UK tax differ from the Tennessee tax in terms of its ultimate burden. The Tennessee tax, like the UK VAT, may be assessed on intermediaries, but the burden of the tax in both instances is generally passed on to the final consumer as a part of the cost of the final good. See *Treasury Department Report To The President: Tax Reform For Fairness, Simplicity, And Economic Growth, Vol. 3, Value Added Tax* 5, 13 (1984); J. Due, *Sales Taxation* 5, 12-25, 365-366 (1957). The Tennessee tax and the UK VAT are also similar in that certain commodities and services are exempted from their coverage. The Tennessee general sales tax differs from the VAT in that it applies at a lower rate, and with a different credit mechanism, than the UK VAT. None of these similarities and

3. *The "Objective" Of The Customs Conventions Does Not Forestall Application Of The Tennessee Tax*

Passing beyond the narrow and specific language of the Conventions, petitioner argues (Pet. Br. 17-27) that the Tennessee tax is inconsistent with the "objective" of the Conventions. Recognizing that the literal scope of the Conventions goes no farther than proscribing application of customs duties, petitioner claims that the Tennessee tax "would substantially reduce the very benefit that Congress intended to confer by exempting containers from *federal* Customs duties" (Pet. Br. 20).[14]

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differences, however, has any bearing on whether *either* tax is chargeable "by reason of importation." Indeed, since the UK applies its tax to the value of container leases at the time of importation of the goods, it would appear that the UK tax—rather than Tennessee's generally applicable sales tax—more closely proximates a tax "chargeable by reason of importation" (Pet. App. 41a) within the language of the Customs Conventions.

[14] Petitioner states (Pet. Br. 20-21 & n.15) that the duty rate generally applicable to foreign-manufactured containers (not entered into the United States under customs bond) fell from 2.5% in 1983 to 0.6% in 1986. The duty rate to which petitioner refers became zero in 1987. See Tariff Schedules of the United States Annotated (TSUS) para. 640.30 (1987).

The duty rate provided by the schedule to which petitioner refers, however, was *not* applicable to modern freight containers used for intermodal traffic and, therefore, presumably was not applicable to petitioner's containers (see note 1, *supra*). Beginning in 1983 (the first year of relevance to this case), and continuing to the present date, *no* duty is assessed on "[f]reight containers specially designed and equipped to facilitate the carriage of goods by one or more modes of transport without intermediate reloading, each having a gross mass rating of at least 40,000 pounds (provided for in 640.30) * * *." TSUS 911.80 (1983). See also TSUS 911.80 (1987); Harmonized Tariff Schedule of the United States 8609.00 (1992) (no duty for containers "specially designed and equipped for carriage by one or more modes of transport").

Petitioner thus errs in its speculations (Pet. Br. 20-21) concerning the amount of duties that it saved by entering its containers under bond during 1983-1986. No customs duties were owed during those years for intermodal cargo containers, even for foreign-manufactured

Of course, the Tennessee tax does nothing of the sort. The exemption "from *federal* Customs duties" is wholly unaffected by the Tennessee tax. The benefit conferred by exemption "from *federal* Customs duties" exists independently of the Tennessee tax and is not altered or reduced by that tax. As this Court stated in rejecting a similar claim that the "objective of [a tax] treaty" extended beyond the confines of its language, "[t]he immediate and compelling answer to this contention is that * * * the language of the Convention itself not only fails to support the petitioner's view, but is contrary to it" (*Maximov* v. *United States*, 373 U.S. at 53, 54).

Nor does *Japan Line Ltd.* v. *County of Los Angeles*, 441 U.S. 434 (1981), support petitioner's argument in this regard. In *Japan Line*, the Court relied on the Commerce Clause, not the "objective" of the Customs Conventions, to preempt the State's property tax on foreign-owned containers. See *id.* at 451-457. In the context of its Commerce Clause analysis, the Court made reference to the Customs Conventions only as indicating "[t]he desirability of uniform treatment of containers used exclusively in foreign commerce" (*id.* at 452). The Court did not adopt or rely upon the argument—advanced by petitioner in this case—that this "objective" of the Customs Conventions, by its own force, preempts the States from imposing general taxes.

Petitioner also errs in suggesting (Pet. Br. 21) that containers that have been temporarily admitted under customs bond are, by virtue of that fact, shielded from all forms of state taxation. Neither in *Japan Line* nor elsewhere has this Court adopted the broad proposition that the temporary admittance of an article under customs bond immunizes the article from all forms of federal or state taxation. In particular, *McGoldrick* v. *Gulf Oil Corp.*, 309 U.S. 414 (1940), and *Xerox Corp.* v. *County*

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containers entered without customs bond. That is not, of course, to say that duties on such articles could not be imposed in the future.

of Harris, 459 U.S. 145 (1982)—which interpreted the preemptive force of the statutory scheme involving bonded Customs Warehouses—do not support this broad submission. Instead, as this Court has stated, the scope of the preemption resulting from a customs bond must be determined by analysis of the "congressional intent" in providing bonded admission (*Xerox Corp.* v. *County of Harris*, 459 U.S. at 153).[15]

Here, as in *R.J. Reynolds Tobacco Co.* v. *Durham County*, 479 U.S. 130 (1986), imposition of the State's sales tax on container leases is "nothing more than an expected cost of doing business" (*id.* at 145). A tax on the value of such services is assessed not only by Tennessee, but abroad. There is nothing in the history of the Conventions or of 19 U.S.C. 1322(a) to suggest that Congress intended "[d]omestic producers and local taxpayers [to] 'subsidize'" (479 U.S. at 145) the use of instruments of international traffic. To the contrary, both the Conventions and the regulations under 19 U.S.C. 1322(a) go no farther than allowing temporary importation of containers without "payment of duty" (19 C.F.R. 10.41a(a)(1)). There is no suggestion in the language

[15] To the extent that the brief filed by the United States in *Japan Line* suggested that *McGoldrick* could have application in interpreting the effect of the Container Conventions (see Pet. Br. 26-27), that suggestion was not adopted by this Court in *Japan Line* and is inconsistent with the Court's subsequent analysis in *R.J. Reynolds*. Moreover, *Japan Line* concerned the treatment of foreign-owned containers under the Container Conventions. The Conventions have no application to the domestically owned containers involved in this case. See pages 7-11, *supra*. Furthermore, *Japan Line* involved application of a local property tax in a manner that was inconsistent with the customary practice of Nations (441 U.S. at 447). It was in that context that the local tax was said to conflict with the general "desirability of uniform treatment of containers involved in foreign commerce" (*id.* at 452). By contrast, there is no customary (and certainly no uniform) practice for Nations not to apply their general taxes to container leases. The unanchored goal of "uniformity" on which petitioner seeks to rely is thus not offended by the State's tax in this case.

or history of the Conventions or of 19 U.S.C. 1322(a) that petitioner's imported containers should not share the cost of government that protects them, along with domestically produced containers used in international traffic and similar instruments of domestic traffic. Cf. *Michelin Tire Corp.* v. *Wages*, 423 U.S. at 286, 288-289, 293-294; *Washington Revenue Dep't* v. *Stevedoring Ass'n*, 435 U.S. at 745, 748, 751-755.

In any event, as we have shown, nothing in the Conventions addresses the treatment afforded by any Nation to its own residents. Nothing in the Conventions or the statute proscribes duties or taxes other than those charged "by reason of importation." And, the common practice of signatory Nations is to permit general sales taxes—or value added taxes—to be applied, either directly or indirectly (see note 11, *supra*), to the value of container leases. To the extent the Conventions and the statute speak *at all* to domestic taxation of domestically owned containers, they do not proscribe sales taxes on container leases.

II. THE COMMERCE CLAUSE DOES NOT PROHIBIT STATE TAXATION OF CONTAINER LEASES

The Tennessee sales tax applies to container leases only when delivery to the lessee occurs within the borders of the State (Pet. App. 20a-21a). Petitioner nonetheless claims that, because this sales tax is not apportioned among the jurisdictions where the leased container is used (Pet. Br. 32-33), and because other Nations may also apply a sales tax to such leases (*id.* at 29-31), the State's tax offends the Commerce Clause.

Apportionment is not ordinarily required for sales taxes, precisely because "the tax is imposed only upon * * * a discrete transaction which occurs within one * * * jurisdiction only." *Wardair Canada Inc.* v. *Florida Dep't of Revenue*, 477 U.S. 1, 9 (1986). See also *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 617 (1981) (upholding state severance tax as to coal shipped out of

state, for "the severance can occur in no other state"); *McGoldrick* v. *Berwind-White Coal Mining Co.*, 309 U.S. 33, 58 (1940) (upholding state sales tax "conditioned upon a local activity, delivery of goods within the state upon their purchase").[16] For example in *Wardair*, the Court upheld Florida's tax on the sale of fuel to common carriers for use in international travel. 477 U.S. at 9.[17] Here, as in *Wardair*, "there is no threat of multiple international taxation" (*ibid.*) because the State's tax is limited to leases of containers delivered to lessees in Tennessee, "a discrete transaction which occurs within one international jurisdiction only" (*ibid.*).

It is true that the United Kingdom and other European Community Nations may also apply their sales tax equivalent—or VAT—to the lease of the same containers. See pages 14-17, *supra*. It also appears that those Nations would not provide a credit in calculating their VAT for sales taxes paid in non-VAT jurisdictions. See

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[16] When an article is moved from one State to another, it is not uncommon for the second State to apply a "use" tax on the article and to give a credit, in the calculation of that tax, for the sales tax paid in the first State. See *D.H. Holmes Co.* v. *McNamara*, 486 U.S. 24, 31 (1988). In calculating its use tax—which is not involved in this case—Tennessee follows the practice of providing a credit for prior sales taxes "paid * * * in another state." Tenn. Code Ann. § 67-6-313(f).

Petitioner claims, without citation of authority, that the State would interpret its use tax credit provision not to apply to foreign sales taxes (Pet. Br. 36). Even if it did, that would have no bearing on the constitutionality of the State's *sales* tax as applied in this case.

[17] In *Wardair*, the Court noted that the taxpayer's only challenge to the State's tax was based upon the claim that the tax "threaten[ed] the ability of the Federal Government to 'speak with one voice' " on matters affecting foreign commerce. 477 U.S. at 9. The Court observed that the other wing of the *Japan Line* analysis—the "threat of multiple international taxation"—was not present in that case because the tax was "imposed only upon the sale of fuel, a discrete transaction which occurs within one national jurisdiction only." *Ibid.*

note 13, *supra*. Unlike the situation that existed in *Japan Line*, however, the risk of multiple taxation that may occur in this situation is not proscribed by the Commerce Clause.

In *Japan Line*, there was an international custom (endorsed by this Court in a long line of decisions) that an ocean-going vessel (and any other instrument of international traffic) was subject to *property* taxes only at its "home port." See *Hays* v. *Pacific Mail S.S. Co.*, 58 U.S. (17 How.) 596, 599 (1855); *Morgan* v. *Parham*, 83 U.S. (16 Wall.) 471, 472 (1873); *Southern Pacific Co.* v. *Kentucky*, 222 U.S. 63 (1911). Recognizing that those decisions "expressing the mandate of the Constitution, express as well the custom of nations," the United States argued in its brief in *Japan Line* that positive law overriding the accepted practice of Nations "can be enacted only at the national level if the nation is to speak with one voice in matters of foreign commerce" (77-1378 U.S. Amicus Br. at 15 (Sept. 1978)). Since the uniform practice of Nations had been "to exempt foreign-owned" vessels and containers from property taxes, and to allow the "home port" Nation to tax the full value of such property, the United States submitted in *Japan Line* that the California tax was responsible for the resulting double taxation of the property and that it should therefore yield under the Commerce Clause (*id.* at 28-29 & n.22).

While the Court found no fixed, constitutional requirement for the "home port" rule in *Japan Line* (441 U.S. at 441-444), the Court agreed that the California property tax on foreign-owned containers conflicted with established international practice (*id.* at 447) and thereby interfered with our government's ability to "speak with one voice when regulating commercial relations with foreign governments" (*id.* at 449 (quoting *Michelin Tire Corp.* v. *Wages*, 423 U.S. at 285)). The Court also noted that, since "the country of domicile" has the "right, consistently with the custom of nations, to impose a tax on [the] full value" of "instruments of international traffic"

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(*id.* at 447), a double tax on the property "inevitably results" when the State taxed the foreign-owned instruments of international traffic. *Ibid.*

There is no international custom exempting the owners of containers from tax *in their own Nation.*[18] See notes 5, 13, *supra.* The rationale for the "home port" rule requires precisely the opposite conclusion: international custom *permits* governments to tax containers owned domestically. Moreover, as the EC and UK practice reflects, there is also no international custom exempting the value of container leases or other international transport services from general sales tax or VAT taxation. See pages 14-17, *supra.*

Far from conflicting with international custom, the Tennessee tax appears to promote it. The Tennessee tax thus does not interfere with our ability "to speak with one voice" on this issue involving foreign commerce. If the United States desires, through future multilateral negotiations, to seek an international custom or practice proscribing such taxation, there will be time enough for appropriate conventions or treaties to be adopted. Until then, we see no deviation from international custom in the Tennessee tax sufficient to require constitutional proscription under the Commerce Clause.

Nor, in this context, can it be said that Tennessee is responsible for any duplication in the taxes that the UK or other EC Nations may impose as the result of those Nations' refusal to provide a credit for the Tennessee tax in their VAT calculations. See note 13, *supra.* While the States of the United States customarily provide such a

[18] Petitioner's argument would suggest that a state retail sales tax could not constitutionally be applied to the sale or lease of an airplane for use in transporting passengers internationally if the foreign nation elected to impose a "use" tax on the airplane and gave no credit for prior sales tax payments. The Commerce Clause, however, does not deprive the States of all taxing authority with respect to instruments employed, or services provided, in connection with international trade. See, *e.g., Washington Revenue Dep't* v. *Stevedoring Ass'n,* 435 U.S. at 743-751.

credit in imposing use taxes on goods already subjected to sales tax in another State (*e.g., D.H. Holmes Co.* v. *McNamara,* 486 U.S. at 31; note 15, *supra*), Tennessee can not be faulted for the failure of *other* Nations to provide such a credit in application of their conceptually different tax systems. Any double tax on container leases that results in these circumstances is the product of differing national tax practices, not international custom. The Commerce Clause has never been held to require the States to serve as the equilibrator of world-wide tax burdens.

It bears emphasis that the "multiple taxation" argument that petitioner advances under the Commerce Clause with respect to container leases is equally applicable, and equally unavailing, with respect to any other product sold or service provided in connection with export commerce. Foreign nations that apply a VAT system of taxation—and that do not give a credit in the calculation of their VAT for sales taxes collected in the United States—impose a tax on all goods (including the cost of transporting those goods) imported in their borders; in this respect, these foreign taxes could be said to create a "multiple" burden on export traffic. Under petitioner's view of the Commerce Clause, the States would be deprived of their ability to apply neutral sales and gross receipts taxes not only to all such export activities, but also to the initial and intermediate economic activities that precede the export stage. There is no basis for such an intrusive and expansive interpretation of the Commerce Clause. See *Washington Revenue Dep't* v. *Stevedoring Ass'n,* 435 U.S. at 757; *Canton R.R.* v. *Rogan,* 340 U.S. 511 (1951).

For the same reasons that led this Court in *Japan Line* to conclude that foreign nations possess a prior right to tax foreign-owned instrumentalities of commerce, so too does this Nation—and the States—possess the power to tax domestically owned instrumentalities of commerce.

III. THE IMPORT-EXPORT CLAUSE DOES NOT PROHIBIT STATE TAXATION OF CONTAINER LEASES

Petitioner also asserts (Pet. Br. 40-47) that the Tennessee sales tax on container leases is barred by the Import-Export Clause of the Constitution and claims that the decisions upholding the state tax in this case "undeniabl[y]" conflict with *Richfield Oil Corp.* v. *State Board of Equalization*, 329 U.S. 69 (1946). *Richfield Oil* concerned application of a state sales tax to oil sold and delivered into a tanker waiting in the Los Angeles harbor for shipment to Auckland, New Zealand. The Court held that the State could not impose its sales tax on this export sale of goods.[19] By contrast, in *Michelin Tire Corp.* v. *Wages*, this Court upheld application of a general state tax to imported goods awaiting shipment in inland warehouses. 423 U.S. at 302. Petitioner explores at some length (Pet. Br. 42-47) whether the Court's reasoning in *Michelin Tire* undercuts the rationale of *Richfield Oil* and deprives it of further validity. See also *Joy Oil Co.* v. *State Tax Comm'n*, 337 U.S. 286 (1949); *Empresa Siderurgica* v. *County of Merced*, 337 U.S. 154 (1949); L. Tribe, *American Constitutional Law* 472-473 (2d ed. 1988).

However interesting that question might be, it has no bearing on the disposition of this case. Neither *Michelin Tire* nor *Richfield Oil* applies here because the leasing of containers does not concern either "exports" or "imports." The American-owned truck or railroad car that carries goods from points in this country to consignees in Canada or Mexico *carries exports, but is not itself an export*. The same is true of American-owned ships or

[19] In *Louisiana Land & Exploration Co.* v. *Pilot Petroleum Corp.*, 900 F.2d 816 (5th Cir.), cert. denied, 111 S. Ct. 248 (1990), the court similarly concluded that the Import-Export Clause proscribed application of the state sales tax to an export sale of oil into a tanker waiting in the Mobile harbor for shipment to Halifax, Nova Scotia.

airplanes carrying goods to more remote consignees. The goods will be left at their foreign destinations while the instrument of international traffic, not itself an export, returns for further voyages. The same is true, of course, of the containers that petitioner leases for the carriage of goods out of the United States. The containers will be returned to petitioner for further leases and further voyages. The goods the containers carry are exports, but the containers are not.

This distinction was recognized by this Court in *Canton R.R.* v. *Rogan*, 340 U.S. 511 (1951). The railroad in that case operated solely within Baltimore, moving freight between its marine terminal at the port of Baltimore and connecting railroads. Invoking the *Richfield* case, the railroad claimed that the portion of its gross receipts that represented the proceeds of handling imports and exports was exempt from Maryland's gross receipts tax. In rejecting that claim, the Court stated (*id.* at 513-514):

> If this were a tax on the articles of import and export, we would have the kind of problem presented in * * * *Richfield Oil Corp.* v. *State Board* * * * and *Joy Oil Co.* v. *State Tax Comm'n* * * *. But the present tax is not on the articles of import and export [.] * * * The difference is that in the present case the tax is not on the *goods* but on the *handling* of them at the port.

See also *Washington Revenue Dep't* v. *Stevedoring Ass'n*, 435 U.S. at 757 (upholding a gross receipts tax that fell "upon a service distinct from the goods and their value").[20]

[20] In *R.J. Reynolds Tobacco Co.* v. *Durham County*, 479 U.S. at 153, the Court rejected the claim that a state ad valorem property tax interfered with federal regulation of foreign commerce or constituted a "duty" proscribed by the Import-Export Clause. The Court noted that the State's generally applicable tax "falls on imported and domestic goods alike and does not single out imported goods for unfavorable treatment." *Ibid.* That same conclusion applies to this case.

As the Court concluded in *Canton R.R.* v. *Rogan*, "if the handling of the goods at the port were part of the export process, so would *hauling them to or from distant points* or perhaps mining them or manufacturing them." 340 U.S. at 515 (emphasis added). The Tennessee Supreme Court was thus correct in concluding (Pet. App. 18a) that application to container leases of a generally applicable tax on the sale or lease of tangible personal property is not a tax on exports even though the leased containers may be used in "hauling [imports and exports] to or from distant points" (340 U.S. at 515).

CONCLUSION

The judgment of the Supreme Court of Tennessee should be affirmed.

Respectfully submitted.

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In The

Supreme Court of the United States

October Term, 1991

ITEL CONTAINERS INTERNATIONAL CORPORATION,

Petitioner,

v.

JOE HUDDLESTON,
COMMISSIONER OF REVENUE OF TENNESSEE,

Respondent.

On Writ Of Certiorari To The Supreme Court Of Tennessee

BRIEF AMICI CURIAE OF PACIFIC MERCHANT SHIPPING ASSOCIATION, STEAMSHIP OPERATORS INTERMODAL COMMITTEE, COUNCIL OF EUROPEAN AND JAPANESE NATIONAL SHIPOWNERS' ASSOCIATIONS AND AMERICAN INSTITUTE OF MERCHANT SHIPPING IN SUPPORT OF PETITIONER

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All references in this brief to "Brief for the United States" are to the brief which was filed by the United States in response to the petition.

INTEREST OF AMICI CURIAE

Amici are associations of international ocean carriers[1] which, as lessees of cargo containers, will be required to pay sales tax imposed on container lease hire if the tax here is upheld.[2] The members of the associations include most of the foreign and American containership operators engaged in North American foreign trades. These carriers lease the foreign built cargo containers at issue for use in international commerce, and they pay the per diem charges thereon which are subject to the tax.

The members of the amici associations have a direct stake in the outcome of this case. They will bear not only the state sales tax burden but also the consequences of

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[1] Amici Pacific Merchant Shipping Association and Steamship Operators Intermodal Committee are trade associations whose members are foreign and American ocean carriers operating in United States and worldwide foreign trades. The Council of European and Japanese National Shipowners' Associations is an international association composed of national associations of foreign shipping companies engaged in worldwide trades. The American Institute of Merchant Shipping is an association of American ocean carriers whose vessels are registered in the United States and who operate in worldwide commerce.

[2] As is the case with most sales taxes, Petitioner is required to attempt to collect the tax from the ocean carriers. Tenn. Code Ann. § 67-6-502 (1989); *see* Cal. Rev. & Tax. Code § 6203 (West Supp. 1992) (the retailer "shall . . . collect the tax from the purchaser . . . ") As the Court observed in *Goldberg v. Sweet*, 488 U.S. 252 (1989): "The tax at issue has many of the characteristics of a sales tax. It is assessed on the individual consumer, [and] collected by the retailer . . . "

any foreign retaliation or multiple tax sought to be imposed by any of the many foreign tax jurisdictions in which the carriers, their vessels and their containers are found. Amici are concerned that both the tax at issue and counterpart state use taxes are highly provocative internationally, that revenues from such transactions are readily subjected to multiple taxation, and that the tax likely will trigger adverse foreign tax reactions.

The ocean carriers also have a significant stake in the manner in which the tax is calculated. The tax applies to all per diem charges owed under a lease involving a change in possession in Tennessee, not just to charges for use of the containers in the state and in the United States. The tax reaches charges for the large numbers of lease days that the containers are aboard vessels, moving within foreign countries or in the possession of connecting carriers, cargo shippers or consignees. Ocean carriers are affected by the absence of geographic apportionment of the tax, both because of the substantial extra tax cost and because absence of apportionment maximizes the chance of foreign tax retaliation affecting American and foreign carriers alike.

The stake that the ocean carrier members of the amici associations have in the outcome of the case is large. First, containers are found, stored, used and change possession repeatedly in virtually every significant tax jurisdiction in the world, making the ocean carriers especially vulnerable to multiple taxation. Second, the sheer size of their container fleets and the frequency of container leasing create substantial potential tax liability. Three to four

containers are required for every container space on a vessel because of the large amounts of time containers spend in the possession of connecting carriers or being loaded, discharged, stored and positioned ashore.[3] In a trade like the North American trade with Asia, the collective container fleet employed at any given time likely exceeds 500,000.[4]

Amici submit this statement to urge the Court to hold that the Commerce Clause and the Supremacy Clause, coupled with the Customs Conventions on Containers, preclude State taxation of containers present in the United States only as instruments of foreign commerce.

Pursuant to Rule 37, this brief is filed with the consent of all parties. Letters of consent from counsel have been filed with the clerk.

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[3] *See* R.F. Gibney, *Containerization Report*, Seatrade, April 1982, at 105, 107, 129.

[4] By 1986 the worldwide container fleet was estimated to number almost 5 million containers – nearly a doubling of the size of the fleet over a five-year period. T. F. Barnett, *Container Care and Feeding*, Pacific Maritime Magazine, Oct. 1986, at 12, 13. These container fleets are enormously costly to ocean carriers, whether the cost is experienced as a direct capital cost or as lease-hire. A new forty-foot dry cargo container costs about $6,800. A new forty-foot refrigerated container costs about $35,000.

STATEMENT

1. Facts.

This case involves a retail sales tax imposed upon gross lease hire paid by international ocean carriers for leasing foreign built ocean cargo containers. App. 30a-32a.[5] The containers enter the United States as instruments of foreign commerce under Customs bond assuring only such use. App. 30a. By treaty obligation, the United States admits them "free of 'all duties and taxes whatsoever chargeable by reason of importation.' "[6] Such containers must leave the country within a maximum period of three months.[7] Thus, the containers can only change possession under lease in the United States by reason of having previously been imported and admitted to the United States under Customs bond in import commerce and by reason of the companion requirement that they leave the country.

Although Tennessee exempts from sales and use tax the transfer of railroad rolling stock or vessels for use in interstate commerce,[8] no exemption is accorded to ocean cargo containers admitted under treaty and Customs bond and used exclusively in foreign commerce.

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[5] The Appendix to the Petition is cited throughout this brief as "App."

[6] *Japan Line Ltd. v. County of Los Angeles*, 441 U.S. 434, 453 (1979); *see* Customs Convention on Containers, May 18, 1956 [1969] art. 2, 20 U.S.T. 301, 304 ("1956 Convention"), App. 42a; 19 U.S.C. § 1322(a), App. 43a; 19 C.F.R. §§ 10.41a(a), 115.1 (1991), App. 43a-44a.

[7] Customs Convention on Containers, Dec. 2, 1972 [1985] art. 4, 988 U.N.T.S. 43 ("1972 Convention"), App. 40a.

[8] Tenn. Code Ann. § 67-6-321 (1989).

The lease hire that is subject to the Tennessee sales tax is calculated on a per diem basis. App. 30a. Consequently, the tax varies in direct proportion to days that containers are under lease. App. 36a.

The sales tax applies whenever possession of leased containers is transferred to a lessee in Tennessee, regardless of where the lease is entered into, where payments are made, or what the nationalities of the parties are.[9] The tax is not limited to revenues generated only by lease days in which the containers are used in Tennessee or in the United States. Consequently, the tax which ocean carriers will bear applies to use of leased containers aboard vessels and in foreign countries and their use by connecting carriers in other jurisdictions. The tax applies even to periods that the containers are sub-leased by ocean carriers to other carriers outside Tennessee.

The ocean carriers use the containers as ship's equipment to transport cargoes in international commerce. *See Japan Line, supra*, 441 U.S. at 442-43; App. 34a-35a. Because of the length of ocean voyages and the time required for inter-carrier transfers, terminal handling and inland deliveries, containers are normally outside the United States as well as outside Tennessee during most of the lease term. Leases covering containers changing possession in the United States are frequently entered into and paid for abroad and are frequently transactions to which the only parties are foreign entities. Most

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[9] Tenn Code Ann. § 67-6-204 (1989); App. 27a, 36a. About 80 percent of Petitioner's lessees are foreign companies, primarily ocean carriers. *See* Tr. 31-33; App. 30a. Petitioner has no leasing or marketing employees located in Tennessee, and none of the leases at issue were entered into in Tennessee. App. 30a-34a.

containership operators are foreign.[10] In this case the leases subjected to tax were entered into in California, involved an American leasing company and included both short term individual leases and master interchange agreements covering multiple containers, supplied at different times on demand. App. 27a, 30a, 32a.

In addition to the charges paid to lessors, ocean carriers themselves levy charges for container use which are potentially subject to tax. Ocean carriers commonly have interchange agreements with connecting motor carriers under which per diem charges are assessed if the containers are not timely returned. Similarly, cargo interests are assessed per diem charges by ocean carriers if containers are detained beyond the time permitted in the ocean freight tariffs or if they are not picked up from carrier terminals in a timely manner.[11]

2. State Court Ruling.

This case arose when Tennessee audited container leasing companies having container depots in the state

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[10] American carriers owned as of 1982 only about 16 percent of world container vessels. R.F. Gibney, *Containerization Report*, Seatrade, April 1982, at 105, 107. The same containers used in United States/foreign trades are used in foreign-to-foreign trades. Moreover, it is leased containers which circulate most. T.F. Barnett, *Container Care and Feeding*, Pacific Maritime Magazine, Oct. 1986, at 12, 15.

[11] *See, e.g.*, Transpacific Westbound Rate Agreement Westbound Local and Intermodal Rules Tariff, FMC No. 10, Rules 32, 21-A and B, 91-C and D and 92-A – 92-L (filed with the Federal Maritime Commission); 46 C.F.R. §§ 580.5(d)(21) & 580.17 (1991); 55 Fed. Reg. 10242 (1990).

and imposed back taxes and penalties on Petitioner for failing to pay tax under Tennessee's Retailers' Sales Tax Act. The Tennessee Chancery Court interpreted the statute as applicable only to containers changing possession in the state by going on lease to ocean carriers, and it held that the tax was not applicable to containers delivered to cargo shippers for loading in Tennessee but going on lease to ocean carriers only when the container arrived at the ocean port. App. 20a-21a.[12] The Chancery Court ruled that the Constitution permits Tennessee to levy sales tax on the worldwide lease hire paid by the ocean carriers if possession of the containers passes to the ocean carrier in Tennessee. *Id.*

In affirming the Chancery Court, the Tennessee Supreme Court concluded that a sales tax imposed on container lease hire "is more analogous to a sales tax on fuel," sold from domestic supplies to foreign aircraft for consumption in flight, than to property taxes on the assessed value of cargo containers. App. 12a.[13] The court thus found that the case was governed by *Wardair Canada,*

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[12] The state where the port is located could levy a sales tax. Tennessee, like most States with sales taxes, also has a use tax, which provides: "A tax is levied at the rate of five and one-half percent (5.5%) of the cost price of each item or article of tangible personal property when the same is not sold but is used, consumed, distributed, or stored for use or consumption in this state." Tenn. Code. Ann. § 67-6-203 (Supp. 1991). This use tax could apply to international lease hire when containers change possession between foreign nationals abroad or in other States.

[13] The court rejected a possible argument that the tax could be sustained against constitutional challenge if limited only to leases in which an American leasing company is the lessor.

Inc. v. Florida Dep't of Revenue, 477 U.S. 1 (1986), in which the parties had stipulated that the fuel tax was appropriately apportioned and that there was no prospect of double foreign taxation. The court distinguished *Japan Line Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), which had struck down an apportioned property tax on foreign containers because of the risk of multiple taxation and foreign retaliation. App. 12a, 14a-15a.

The court found dispositive that the Tennessee tax applied only if there were a change of possession of the containers in Tennessee, because foreign countries could not invoke the same taxable event to tax the same lease hire. App. 14a. Although the court noted that "[o]ther nations very well may adopt similar taxes on the transfer of possession of leased containers within their taxing jurisdictions," the court concluded that the Tennessee tax "creates no risk of multiple international taxation." *Id.*

In construing the Customs Conventions on Containers, which this Court has cited as evidencing "[t]he desirability of uniform treatment of containers used exclusively in foreign commerce" (*Japan Line, supra*, 441 U.S. at 452), the state court distinguished between a property tax apportioned to local container use, which conflicts with the uniform treatment contemplated by the Conventions, and sales taxes falling on worldwide container use, which the court held does not create such a conflict. App. 15a-16a. The court rejected the claim that the tax was inconsistent with the Customs Conventions and rejected the argument that the Conventions set forth national policy guiding the proper interpretation of the Commerce Clause. *Id.*

SUMMARY OF ARGUMENT

A sales tax upon lease hire for the use of marine containers in international commerce will be paid by the lessee ocean carriers. That tax should be evaluated under the same constitutional standards applicable to personal property taxes on containers that are owned by ocean carriers and used for the same purpose. The Tennessee court's distinction between a property tax on instruments of foreign commerce and a sales tax upon leases of such property conflicts with this Court's decisions and has no rational basis.

A sales tax, when applied to per diem charges for use of cargo containers confined to foreign commerce, must, as a threshold matter, be apportioned geographically so as to tax only revenues reflecting use of containers in the taxing jurisdiction. A sales tax levied on lease hire from a carrier's use of equipment over time is a tax upon that use wherever it occurs. Absent geographic apportionment, state taxation based on use of containers employed by foreign carriers on the high seas and in foreign countries is highly provocative and the likelihood of adverse foreign tax reactions is much greater than in the case of an apportioned personal property tax. Tennessee made no attempt to apportion its tax to exclude from taxation per diem lease hire from days the containers are used outside the jurisdiction, although such apportionment is possible. Other States have provided for apportionment of sales and use tax levied upon lease hire of such equipment used in interstate commerce so as to tax only lease hire applicable to the period the property is used in the state.

The state court's decision hinges on the erroneous assumption that multiple taxation of the same revenue is not relevant under the Commerce Clause unless both taxes are triggered by the identical event. Foreign countries can tax per diem charges on containers by levying use taxes similar to Tennessee's, based on the containers' storage or use abroad or on whatever other taxable event is chosen. Similarly, Tennessee can impose its use tax on foreign leases between foreign nationals where the containers change possession abroad, if the containers are used or stored in the state.

A tax which applies to revenue from foreign lease transactions between foreign nationals based on foreign use of containers, even if geographically apportioned, would be at least as likely to provoke multiple and retaliatory taxation as an apportioned property tax on the same containers. When a state breaks ranks with international norms by commencing taxation of instruments of foreign commerce and the tax is borne largely by foreign carriers it creates consequences for the United States and foreign countries alike. Foreign countries cannot negotiate with Tennessee concerning Tennessee's tax or retaliate against Tennessee alone. Tennessee's tax position becomes an American tax position. It effectively ties the diplomatic hands of the United States in protecting its own nationals, whether by resisting foreign measures or by mutual compromise concerning the application of both taxes.

The United States is a signatory to treaties whose purpose is to remove impediments to the use of containers as instruments of international commerce. These treaties reflect international custom and practice protecting containers from local taxation by establishing procedures through which containers enter and exit signatory nations free of duties or taxes by reason of importation. The containers at issue here can go on lease in the United States and incur the Tennessee tax only by reason of prior importation, and that importation is under terms that render them tax and duty free under the Customs Conventions on Containers. The narrow interpretation which Respondent has given these treaty obligations defeats their basic purpose.[14]

ARGUMENT

I. APPLICATION OF TENNESSEE'S SALES TAX TO LEASES OF MARINE CONTAINERS IMPERMISSIBLY BURDENS FOREIGN COMMERCE.

A. Sales Taxes On Container Lease Hire Are Subject to the Same Commerce Clause Standards As Property Taxes on Carrier-Owned Containers.

The Commerce Clause of the Constitution, as construed by the Court, permits states to tax instruments of foreign commerce only under limited circumstances. The

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[14] Amici have reviewed in draft Petitioner's argument concerning application of the Export-Import Clause to the Tennessee tax and adopt it.

Court has on varying grounds invalidated state taxes imposed on vessels from outside the taxing jurisdiction, federal taxes on charter hire and state taxes imposed on containers as ship's equipment. *Hays v. Pacific Mail S.S. Co.*, 58 U.S. (17 How.) 596, 598-99 (1855); *United States v. Hvoslef*, 237 U.S. 1, 17 (1915); *Japan Line, supra*, 441 U.S. at 442, 448-49.[15]

> In approving state taxes on the instrumentalities of interstate commerce the Court consistently has distinguished oceangoing traffic, *supra*, at 442; these cases reflect an awareness that the taxation of foreign commerce may necessitate a uniform national rule. Indeed in *Pullman's Palace*, the Court wrote that the "vehicles of commerce by water being instruments of intercommunication with other nations, the regulation of them is assumed by the national legislature." [*Japan Line, supra*, 441 U.S. at 449 (citations omitted).]

A tax on instruments of foreign commerce such as cargo containers must meet both the tests of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), which require a substantial nexus with the taxing State and fair apportionment of the tax, and the tests of *Japan Line, i.e.*:

> whether the tax, notwithstanding apportionment, creates a substantial risk of international multiple taxation and, second, whether the tax prevents the Federal Government from "speaking with one voice when regulating commercial relations with foreign governments". If a state tax contravenes either of these precepts, it is unconstitutional under the Commerce Clause. [441 U.S. at 451.]

[15] The Tonnage Duty Clause of the Constitution (art. I, § 10, cl. 3) prohibits state taxes or fees imposed as a privilege of a vessel call at a port in a state. It is a companion clause to the Export/Import Clause, and it reflects the same fundamental national policy. *See Steamship Co. v. Portwardens*, 73 U.S. (6 Wall.) 31 (1867).

A sales or use tax falls on buyers, who here are the international ocean carrier lessees of the containers – the same persons who would pay property tax on owned containers, absent the Court's ruling in *Japan Line*.[16] Sales or use tax on container leases has the same economic impact on ocean carriers as property taxes imposed on containers they own.[17] Sales or use taxes may have a larger impact than property taxes, especially if the mix of a carrier's container fleet includes a large portion of leased containers. Both taxes are imposed because ocean carriers must use containers within the taxing jurisdiction to move foreign cargoes in foreign commerce. Moreover, container lease hire largely reflects the lessor's own capital cost. A property tax on assessed value and a sales tax on lease hire each reflect the on-going value of the property to the ocean carrier. Unlike a one-time sales tax on the sale of property, Tennessee's sales tax based on total

[16] *See* note 2, *supra*.

[17] "Approximately 50 percent of the world's international container fleet is owned by container leasing companies. The rest of the containers are owned by carriers (46 percent) with small numbers belonging to shippers." G. Muller, *Intermodal Freight Transportation* 138 (2d ed. 1989). The leased containers constitute an equipment fleet whose use is shared by ocean carriers worldwide.

lease hire from recurring transactions operates much like a property tax.[18]

The constitutional standard applicable to a sales tax imposed on container lease hire paid by ocean carriers should be the same as the standard that applies to property taxes paid by ocean carriers on containers they own and use for the identical purpose. The decisions of this Court do not suggest that the constitutional standard differs, or produces different results, because of the label affixed to the tax or because the events selected by the state as the rationale for taxing differ.[19] What matters is whether a container or container lease hire is likely to be taxed more than once.

In applying the Export/Import Clause and exemptions from tax under the Customs laws to invalidate state taxes upon foreign commerce, the Court has not distinguished between sales and property taxes. The Court and a Court of Appeals treated property taxes and sales

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[18] Property taxes can be and are levied on possessory interests in leasehold property just as sales taxes can be applied to the same property. *Compare Seatrain Terminals of California, Inc. v. County of Alameda*, 83 Cal. App. 3d 69 (1978) (possessory interest property tax), *with United States Lines, Inc. v. State Board of Equalization*, 182 Cal. App. 3d 529 (1986) (sales tax). Use taxes, imposed on storage or use of property, are based on presence of the property in the jurisdiction much like a property tax.

[19] The state court's formalistic distinction between a sales tax and a property tax contravenes the Court's commitment to testing a state tax "based upon its actual effect rather than its legal terminology." *Complete Auto Transit, Inc. v. Brady, supra*, 430 U.S. at 281.

taxes similarly in invalidating both types of taxes. *Compare Richfield Oil Corp. v. State Board of Education*, 329 U.S. 69 (1946) (sales tax invalid under Export/Import Clause), *and McGoldrick v. Gulf Oil Corp.*, 309 U.S. 414 (1940) (sales taxes invalid under Customs statute), *with Xerox Corp. v. County of Harris*, 459 U.S. 145 (1982) (property tax on bonded goods preempted), *and Louisiana Land & Exploration Co. v. Pilot Petroleum Corp.*, 900 F.2d 816 (5th Cir.), *cert. denied*, 111 S. Ct. 248 (1990) (invalidating excise tax under Export/Import Clause). The state court erred in distinguishing the above cases simply because they were rulings under the Export/Import Clause or Customs statutes, rather than under the Commerce Clause. *See* App. 10a.[20] These cases demonstrate that, in determining whether state taxes burdening foreign commerce pass constitutional muster, no distinction should be made between property and sales taxes because in both cases the burdens on foreign commerce are the same.

B. Tennessee's Sales Tax Fails A Critical Threshold Test Because It is Not Geographically Apportioned.

Tennessee's tax, as applied to lease hire for carrier use of instruments of foreign commerce, fails a basic test that *Japan Line* treated as a threshold requirement. The

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[20] The state court also found it significant that, under the statute addressed in *McGoldrick* and *Xerox*, the goods were in bonded warehouses "in the joint custody and continuous control and supervision of customs officers and the warehouse proprietor." App. 9a. However, in the case of bonded warehouses, custody, continuous control and supervision by customs officers are largely legal fictions.

test rejects taxes that, because unapportioned, intrinsically have such a high probability of provoking multiple or retaliatory foreign taxes that it is unnecessary to analyze separately the probability of adverse foreign reaction. Although *Japan Line* makes clear that apportionment of a tax imposed on instruments of foreign commerce is not enough to save the tax, it also makes clear that proper apportionment is essential if such a tax is to have any prospect of being upheld. 441 U.S. at 447, 450-51.

In *Japan Line*, the apportionment that met the Court's threshold test was based on "average presence" of marine containers in the jurisdiction over the course of a year. *Id.* at 437. The apportionment requirement was explained in *Goldberg v. Sweet*, 488 U.S. 252 (1989), in the context of an excise tax on interstate commerce treated by the Court as a sales tax. A state may tax:

> only that portion of the revenues from the interstate activity which reasonably reflects the instate component of the activity being taxed. [*Id.* at 262.]

Only if the state tax meets the apportionment test is it necessary for a court to determine whether the tax "notwithstanding apportionment" is likely to create double or retaliatory taxation or prevents the United States from speaking effectively with one voice. *Japan Line, supra*, 441 U.S. at 451.

Goldberg involved interstate telephone calls in domestic commerce and a proposal for geographic apportionment of millions of electronic impulses not capable of being apportioned by the traditional geographic allocation used in the case of large, tangible instruments of commerce like trucks or containers. Hence the tax there

was allocated by permitting each state to tax calls billed to an address in the state, regardless of where the call was initiated or received. *Goldberg* approved an apportionment of sales tax based on practical considerations concerning the matter taxed. It also made clear that the appropriate apportionment for "the movement of large physical objects over identifiable routes, where it was practicable to keep track of the distance actually traveled within the taxing State" is geographical apportionment reflecting use of the equipment in the jurisdiction. *Id.* at 264. Indeed, that is the basis on which other taxes on motor carrier equipment are required to be apportioned. *See American Trucking Ass'ns v. Scheiner*, 483 U.S. 266, 291-92 (1987).[21]

Application of *Japan Line's* geographic apportionment requirement to sales or use tax imposed on lease hire paid by carriers for the use of instruments of foreign commerce is not novel. Nor does it affect the generality of sales and use taxes applied outside this specialized context. It is already the basis on which some states, undoubtedly in recognition of Commerce Clause constraints, have apportioned their sales and use tax as applied to leases of such equipment. California and Wisconsin provide for apportionment of sales or use tax applicable to leases of personal property which are treated as

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[21] Ocean cargo containers are physically similar to motor vehicle trailers with the minor exception that ocean containers are removable from the underlying wheeled chassis to permit movement more readily on vessels and rail cars as well as by highway. Geographic apportionment is a minimal requirement for both types of equipment, but particularly so as to containers dedicated to foreign commerce because their taxation raises all the problems outlined in *Japan Line*.

> . . . a continuing sale . . . as respects any period of time the leased property is situated in this state, irrespective of the time or place of delivery of the property to the lessee or such other person. [Cal. Rev. & Tax. Code § 6006.1 (West 1987); *see* Wisc. Stat. § 77.51(j) (1990).]

Wardair Canada, Inc. v. Florida Dep't of Revenue, 477 U.S. 1 (1986), did not eliminate *Japan Line*'s threshold apportionment requirement as applied to sales taxes imposed on leasing instruments of commerce.[22] The case involved a tax on domestic fuel supplies sold to aircraft. The airline claimed that, where fuel sales were made to foreign aircraft to be consumed in flight, the sale could not be subject to local fuel taxes. It was conceded in *Wardair* that the tax *was* appropriately apportioned and that there was no prospect of multiple taxation by foreign countries when the aircraft arrived there. *Id.* at 8. The Court upheld the tax. No other country was likely to tax fuel largely consumed in the international flight, and each country could tax its own domestic fuel sales to the aircraft for the next flight. *Wardair* has no relevance to the apportionment which *Japan Line* and *Goldberg* require here.

Even if a state unilaterally apportions its tax, a sales or use tax on container lease hire creates the same international problems that were fatal to the apportioned property tax at issue in *Japan Line*, because there is no

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[22] *Department of Revenue v. Ass'n of Washington Stevedoring Cos.*, 435 U.S. 734 (1978), is an example of a tax (there a business gross receipts tax) that did not require apportionment because the sole activity taxed was confined to the taxing state, and neither the taxpayer nor the gross revenue could be taxed elsewhere. The Court was careful to note that "[n]o foreign business or vessel is taxed." *Id.* at 754.

international agreement on apportionment and no international referee. An *unapportioned* sales or use tax *a fortiori* violates the Commerce Clause because it taxes per diem container lease hire for lease days when the containers are used abroad or on the high seas. An unapportioned tax like the one at issue here is a far blunter instrument and is much more provocative than an apportioned property tax.

Clearly, the Tennessee tax, which is not apportioned to reflect use of the containers in the state, violates the Constitution. Unlike the taxes on electronic impulses in *Goldberg* or taxes on sale to foreign aircraft of domestic fuel to be consumed in flight in *Wardair*, the lease hire days to which the tax here applies are readily apportioned geographically based on traditional methods.[23] No effort was made by Tennessee to apportion the tax geographically, and such failure in this context is fatal to the tax.

C. The Tennessee Tax Is Likely to Subject Container Lease Hire to Multiple Taxation.

The lease hire involved in this case could clearly be taxed by foreign countries. Indeed, the state court conceded that

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[23] Allocation methods include use of a ratio of days in the jurisdiction as compared to total lease days, as under California's tax (Cal. Rev. & Tax. Code § 6006.1 (West 1987)), mileage ratios reflecting distance traveled, or less costly formulae approximating the same.

> Other nations very well may adopt similar taxes on the transfer of possession of leased containers within their taxing jurisdictions. [App. 14a.]

Tennessee's own use tax, like most state use taxes, would subject lease hire revenues to use tax when containers go on lease outside the state but are used or stored for use in the state. *See* Tenn. Code Ann. § 67-6-203 (Supp. 1991). Foreign countries could do the same based on container use there.

The state court erroneously assumed that its inquiry into potential multiple taxation ended under *Japan Line* if foreign governments taxing the same lease hire could not do so *by basing their tax solely upon the identical "discrete transaction" selected by Tennessee*. This approach confuses the question whether multiple taxation or retaliation by foreign governments can or will occur with the question whether taxation of the same revenue could be based on the identical event selected by Tennessee.

Japan Line requires rejection of this extremely narrow approach. The state court's analysis nearly defines multiple taxation out of existence as a constitutional concern and makes the entire analysis of potential adverse foreign reaction required by *Japan Line* largely irrelevant. In *Japan Line*, Los Angeles sought to tax containers based on their presence in the jurisdiction, while Japan apparently taxed the containers based upon ownership by Japanese carriers and their use on Japanese vessels. 441 U.S. at 436. That the duplicative taxes were triggered by different premises did not save the apportioned California tax. Tennessee's attempt to distinguish its unapportioned sales tax on the ground that any multiple taxation of the same lease hire would be triggered by slightly different taxable events improperly displaces the practical analysis

required by *Japan Line* with conceptual labels. The proper test is whether the same container lease hire is likely to be taxed more than once, not whether the particular taxable event chosen by a state can occur only in one place.

State sales and use taxes, common in American states, both apply to the same interstate sales revenues. Clearly there would be duplicate taxation if both taxes were assessed on the same revenue. Yet sales tax is based on a change in possession of the property while use tax on the same revenue is based on use or storage of the same property in another state. What saves these duplicative taxes under the Constitution is that domestic use taxes generally provide credit for sales tax paid in other states,[24] not that both taxes could permissibly apply because based on different taxable events.

Duplicative state sales and use taxes illustrate the serious multiple international taxation problem that ocean carriers face. Since their containers are used, are stored, and change possession all over the world, multiple taxation is both possible and likely once one major nation commences to tax these lease revenues.[25]

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[24] It would appear that such a credit is required by the Commerce Clause, although the Court has not expressly ruled on this issue. *See Williams v. Vermont*, 472 U.S. 14, 21-22 (1985); *Japan Line, supra*, 441 U.S. at 446; *J.D. Adams Mfg. Co. v. Storen*, 304 U.S. 307, 311-12 (1938).

[25] Although *Japan Line* involved actual taxation of the containers in another country, it is clear that the constitutional standard relates to the risk of multiple taxation and does not require awaiting the actual event. *See Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 228-29 (1980); *Mobil Oil Corp. v.*

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Moreover, nothing requires foreign countries imposing use, sales or similar taxes on container lease hire to give credit for sales or use tax paid to American states.

Duplicative taxation will also occur in the case of leased containers changing possession abroad. Under the state court's constitutional rationale, in which double taxation is not prohibited if based on a different taxable event, American states would be free to apply use taxes to transactions in which the change in container possession occurs in foreign countries. *See* Tenn. Code Ann. §§ 67-6-203, 67-6-204 (1989 & Supp. 1991); Cal. Rev. & Tax Code §§ 6006.1, 6203 (West 1987 & Supp. 1992). American states provide no credit against their sales taxes for a use, sales or similar tax paid abroad. *See, e.g.*, Tenn. Code Ann. 67-6-507 (Supp. 1991); Cal. Rev. & Tax Code §§ 6006.1, 6406 (West 1987). Thus even California's apportioned use tax on lease hire would involve double taxation if a foreign tax applied.

The state court erred by relying exclusively upon an internal consistency test which asks whether, if all other jurisdictions applied the identical tax, double taxation would result. *See Goldberg v. Sweet, supra*, 488 U.S. at 261. Such a test assumes a common referee to determine which jurisdiction has tax primacy; it is inappropriate in evaluating taxation of international transactions which each country can tax on any basis it wishes. The state

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Commissioner of Taxes, 445 U.S. 425, 444 (1980). To require the actuality of double taxation before the Court acts would be especially inappropriate in foreign commerce because the United States cannot undo foreign reactions once they occur.

court's reliance solely on the fact that other countries could not tax the lease hire here if their tax were also to depend upon a change of possession in the taxing jurisdiction defeats the test required by *Japan Line* in the context of foreign commerce. That test, assuming apportionment, requires an analysis of whether foreign double taxation is likely and whether the "asymmetry" resulting when states break ranks with international norms is likely to provoke foreign response. *Japan Line, supra*, 441 U.S. at 449-50.

Wardair does not suggest that there could be no duplicative foreign taxation here. In *Wardair* the discrete event causing the Florida tax to apply was a sale of domestic fuel to be consumed in flight making it highly unlikely that foreign countries would tax either the fuel or its sale. Indeed, the parties there conceded that there was no threat of multiple international taxation, as there is here. The tax in *Wardair* was not provocative because it did not tax an instrument of foreign commerce, governed by international conventions designed to preclude duty or tax, but rather taxed the severance of fuel from a fungible domestic supply when purchased for use in foreign and domestic commerce alike. Had Florida instead sought to tax foreign aircraft or to tax charter hire on foreign aircraft paid by the Canadian air carrier for international aircraft use, based on a change in possession in Florida while still in foreign commerce, an entirely different question would have been presented.

Finally, the likelihood of multiple taxation here extends beyond multi-national taxation of the identical lease hire paid by ocean carriers. Possession of containers under lease to ocean carriers changes frequently through sub-leases and interchange of containers with connecting

carriers. These subsidiary changes in possession, which occur both domestically and abroad, are themselves often accompanied by an ocean carrier per diem charge.[26] Thus, even if foreign countries did not tax the basic lease hire taxed by Tennessee, other states or foreign countries in which the leased containers change possession and incur additional charges could impose sales or use tax for the same days that Tennessee is taxing under the basic lease.

D. Permitting The Tennessee Tax To Stand Will Provoke Adverse Foreign Reaction and Preclude the United States From Speaking With One Voice.

For the reasons that the Court emphasized in *Japan Line*, amici suggest that foreign objections and retaliation are likely if American states are permitted to tax international container lease hire.[27]

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[26] A sales tax imposed upon a charge made by the ocean carrier for use of the container by a cargo shipper or consignee would fall on an export or import and would be invalid for that reason. *See Richfield Oil Corp. v. State Board of Equalization*, 329 U.S. 69, 80 (1946), and cases cited therein invalidating federal taxes on charter parties and bills of lading as taxes on exports. A tax on charges to connecting carriers and the tax here should similarly be invalid.

[27] Since this Court has not yet spoken and knowledge of the Tennessee tax is not widespread, no inference can be drawn from the fact that, as yet, foreign countries have not protested or commenced double or retaliatory taxation. *See* Brief for the United States at 7, n.8. So far as is known, Tennessee is the only jurisdiction anywhere to have imposed such a tax. Further, this

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> If a novel state tax creates an asymmetry in the international tax structure, foreign nations disadvantaged by the levy may retaliate against American-owned instrumentalities present in their jurisdictions. [441 U.S. at 450.]

This is such a case. As Petitioner points out, foreign built containers, admitted to a country as instruments of commerce under the Customs Convention on Containers, are not subject to comparable taxes elsewhere. If this Court should uphold the tax, other states needing revenues will apply their sales taxes to similar transactions and their use taxes to transactions in which possession does not change in the state but the containers are used or stored in the state. By such piecemeal actions, the United States will have departed from international practice.

Such unilateral actions will cause international reaction affecting the entire country and its national carriers. Foreign nations whose carriers are adversely affected cannot deal diplomatically with Tennessee or retaliate solely against Tennessee. *See Japan Line, supra*, 441 U.S. at 450, n.16. If foreign nations object through diplomatic channels to the United States or retaliate against Americans, there is no effective way for the United States to negotiate concerning such state taxes and no credible way to oppose similar taxes imposed by other countries. If foreign nations impose similar taxes – for example, taxing lease hire between American leasing companies and American carriers entered into in the United States but

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case arose on audit, and the tax was imposed on Petitioner after the transaction was complete so that the impact of such taxes have not yet been felt by foreign ocean carriers.

involving containers whose possession changes abroad – Tennessee's action here will have made it virtually impossible for the United States to defend its citizens' interests. *Japan Line* recognized this problem with considerable perception:

> A State tax on instrumentalities of foreign commerce may frustrate the achievement of federal uniformity in several ways. If the state imposes an apportioned tax, international disputes over reconciling apportionment formulae may arise. If a novel state tax creates an asymmetry in the international tax structure, foreign nations disadvantaged by the levy may retaliate against American-owned instrumentalities present in their jurisdictions. Such retaliation of necessity would be directed at American transportation equipment in general, not just that of the taxing State, so that the Nation as a whole would suffer. If other States followed the taxing State's example, various instrumentalities of commerce could be subjected to varying degrees of multiple taxation, a result that would plainly prevent this Nation from "speaking with one voice" in regulating foreign commerce. [*Japan Line, supra*, 451 U.S. at 450-51.]

State sales and use taxes create a range of international conflict problems that go well beyond those foreseen in *Japan Line*. American states, applying existing use taxes, could tax revenue from container leases entered into abroad between foreign concerns even where possession changes abroad. Under the rationale used by the state court, such taxes would be constitutional since, if the foreign country imposed a tax based on change of possession or some other event there the state would be taxing a different event. If the foreign country did not tax

because it believed the Customs Conventions on Containers prohibited tax, Tennessee would cite an absence of any conflict. Yet it is hard to imagine a state tax that intruded more on foreign jurisdiction, rights and tax policies or that would more certainly and rightly provoke reaction.

E. Lease Hire Paid by Ocean Carriers May Not Be Subjected to Sales Tax Merely Because the Containers Are Owned By an American Company.

The state court rejected as discriminatory a distinction that would limit sales taxes to those imposed when the lessor is an American concern. App. 8a. The Tennessee court was correct in observing that such a distinction itself raises serious constitutional questions.[28] The Solicitor General, however, has urged adoption of a rule that would limit any constitutional constraints on state taxation of foreign containers to taxes imposed on containers owned by foreign entities or where foreign entities were the lessors stating: "For the same reasons that foreign nations possess a prior right to tax foreign-owned instrumentalities of foreign commerce, so too does this Nation and its States possess the right to tax the domestically owned instruments of commerce." Brief For the United States at 8-9. Under this proposal Petitioner's containers on lease to ocean carriers would be taxed, but those leased by Petitioner's foreign competitors would not.

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[28] *See Sears, Roebuck & Co. v. County of Los Angeles*, 449 U.S. 1119 (1981) *aff'g* 85 Cal. App. 3d 763 (1978); *Star-Kist Foods, Inc. v. County of Los Angeles*, 42 Cal. 3d 1, 14 (1986), *cert. denied*, 480 U.S. 930 (1987).

It is unusual for a government to propose tax discrimination against its own nationals. The only apparent justification for such a proposal, especially in context of fierce and continuing competition in international markets, would appear to be an overriding concern that if Tennessee's tax *were* imposed on transactions involving foreign lessors adverse foreign reaction contemplated in *Japan Line* would be probable. Discriminating against American lessors by imposing tax burdens only on ocean carriers dealing with American companies probably would eliminate the risk of international conflict and double taxation. However, that is because, in the case of price sensitive container leasing, such a ruling would discourage ocean carriers from dealing with American leasing companies. To avoid the tax, foreign lessees need only deal with foreign lessors. That solution to international conflict appears extreme and inequitable. Amici suggest that the correct rule is that containers subject to the Customs Conventions on Containers, and whose use is restricted to foreign commerce, should not be subject to such taxes at all.

II. THE TENNESSEE TAX CONFLICTS WITH THE CUSTOMS CONVENTIONS ON CONTAINERS.

The Customs Conventions on Containers reflect both a national policy and an international commitment by all signatory nations "to remove impediments to the use of containers as 'instruments of international traffic.' " *Japan Line, supra*, 441 U.S. at 453. The Conventions are important here not only as federal law superseding conflicting state law, but also as an important part of the analysis required under the Commerce Clause. Both as written and as uniformly understood and applied in practice, the

Conventions reflect an international consensus that containers admitted to a country as instruments of commerce not be subject to tax.

The Conventions are not properly interpreted simply by reading them as if they were tax regulations or the fine print of insurance policies. Rather they should be "construed more liberally" as an international charter in accordance with their history and "the practical construction adopted by the parties". *See Air France v. Saks*, 470 U.S. 392, 396 (1985); *quoting Choctaw Nation of Indians v. United States*; 318 U.S. 423, 431-32 (1943).

The Conventions preclude both "duties" which are assessed ad valorem on imported articles and "taxes" collected by reason of importation. The construction given to the Conventions by the state court and the Solicitor General is unduly restrictive, because they read "all duties and taxes whatsoever chargeable by reason of importation"[29] and "free of import duties and taxes and free of import prohibitions and restrictions"[30] as narrowly confined to "duties" imposed as of the moment of clearing customs. Clearly, taxes otherwise prohibited by the Conventions are not saved because they happen to be imposed by a state rather than the federal government or because they are imposed at an inland point or at the point of departure from the country. The Conventions could be evaded at will by such an approach. Any government, by assigning the right label to its tax and imposing it after initial import, could defy the Conventions by asserting that its subjective intent was not to tax the container "by reason of importation". This is not an

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[29] 1956 Convention, art. 1(a).

[30] 1972 Convention, art. 1(b).

interpretation that the United States would be likely to countenance if foreign countries so taxed American containers.

The foreign-built containers in question are available for lease in Tennessee only because they have been admitted under the Conventions and Customs regulations implementing them. The Conventions contemplate that the containers leave the country not later than three months after being admitted. 1972 Convention, art. 4. The proper and the only workable construction of the Conventions is that they prohibit any tax imposed on these instruments of foreign commerce, when admitted under Customs bond and in accordance with Customs regulations governing their use. That construction reflects a clear, enforceable line and an unambiguous standard that is free of subjective controversies over the intent of a particular tax. The construction proposed is a workable one which other nations observe. States of the United States should do so as well.

CONCLUSION

Amici respectfully urge the Court to hold the Tennessee tax to be contrary to the Constitution of the United States.

Respectively submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

ITEL CONTAINERS INTERNATIONAL CORPORATION,
Petitioner,

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE,
STATE OF TENNESSEE,
Respondent.

On Writ of Certiorari to the Supreme Court of the State of Tennessee

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BRIEF OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-321

ITEL CONTAINERS INTERNATIONAL CORPORATION,
Petitioner,

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE,
STATE OF TENNESSEE,
Respondent.

On Writ of Certiorari to the Supreme Court of the State of Tennessee

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BRIEF OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND AS AMICUS CURIAE IN SUPPORT OF PETITIONER

This brief *amicus curiae* is submitted with the written consent of counsel to both parties filed with the Clerk of the Court.

INTEREST OF AMICUS CURIAE

The United Kingdom of Great Britain and Northern Ireland is a major trading partner of the United States. Its imports of $22.1 billion of U.S. merchandise in 1991

rank it as the largest European market for U.S. exports and the fourth largest worldwide (after Canada, Japan and Mexico); it exported $18.5 billion of general merchandise to the United States in 1991.[1] Over 98% of the United Kingdom's import/export trade with the United States, in terms of weight, is shipped in ocean-borne commerce;[2] the balance is shipped by air. General merchandise, by and large, is containerized—that is, carried in marine or air cargo containers.[3] About half of the marine containers utilized by international ocean carriers, including container lines domiciled in the United Kingdom, are leased from equipment lessors rather than owned by the carriers themselves. While some air cargo containers are leased by airlines, most are carrier-owned.

The United States is party to the 1956 Customs Convention on Containers and the 1972 convention of the same name.[4] The United Kingdom is party only to the 1956 Convention ("Convention"); therefore, that Convention controls relations between the United Kingdom and the United States on its subject matter. The purpose and structure of the two Conventions is virtually identical: "to develop and to facilitate the use of containers in international traffic"[5] by setting forth rules on the "uniform

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[1] Foreign Trade Division, Bureau of Census, U.S. Department of Commerce. Accord: Statistics of HM Customs and Excise.

[2] *Id.*

[3] In 1991, 3,101,250 tons of containerized cargo were carried between the United States and the United Kingdom, having a value of approximately $13 billion. Statistics of HM Customs and Excise.

[4] Customs Convention on Containers, May 18, 1956, 20 U.S.T. 301, TIAS 6634, 338 U.N.T.S. 103 (entered into force in U.S. on March 3, 1969, entered into force in United Kingdom on August 4, 1959); Customs Convention on Containers, Dec. 2, 1972, 988 U.N.T.S. 43 (entered into force in U.S. on May 12, 1985) ("1972 Convention").

[5] 1956 Convention, preamble. *See* 1972 Convention, preamble, which uses practically the same terms.

treatment of containers used exclusively in foreign commerce."[6]

Her Majesty's Government ("HMG"), a principal architect of the Convention, became a party in order, among other things, to prevent the imposition of duties and taxes on the free flow of containers dedicated to international commerce. With the advent of containerization in the 1950's, it was recognized that a dedicated marine or air cargo container could well traverse trade lanes across the globe many times over during the course of its economic life, especially a leased container since it would likely be utilized by several international carriers over the course of its life. Without the undertakings of governments in a multilateral treaty such as the Convention, the nations of the world (including their political subdivisions) would be free to seize upon any aspect, use or change of possession of an international cargo container to raise revenue, but also to frustrate commerce.

HMG files this brief to apprise the Court of its views regarding the Convention, not to argue the meaning of the United States Constitution. The Tennessee Supreme Court[7] appears to have paid scant attention to the Convention, concluding without explanation that since Tennessee's tax is imposed on a discrete transaction occurring only in Tennessee, the "tax will not hinder the policies embodied in the . . . Convention . . .;"[8] the Convention is not mentioned at all in the Tennessee lower court decision.[9]

HMG considers Tennessee's 5.5% tax on the proceeds of international-commerce container leases as one proscribed by the Convention. Major trading nations that

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[6] *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 452 (1979) ("*Japan Line*") (referring to 1956 Convention).

[7] The decisions of the Tennessee Supreme Court, reported at 814 S.W.2d 29 (Tenn. 1991), and the Tennessee Chancery Court, 20th Judicial District, are reproduced in the Appendix, at 1a-26a, attached to the Petition for a Writ of Certiorari (hereinafter "Pet. App.").

[8] Pet. App. at 16a.

[9] Pet. App. at 19a-23a.

are party to either the Convention or the 1972 Convention have expressed their grave concern to the United States Government over the incompatibility of the Tennessee tax with undertakings under the Conventions. *See* Appendix.

The importance of this case is not limited to Tennessee's tax; if the tax survives petitioner's challenge, the many other states that have enacted (or might enact) sales tax legislation will almost certainly follow suit, creating in effect a patchwork, almost-national U.S. sales tax on container-lease revenue. HMG believes that the application of U.S. state taxes to the lease proceeds of containers dedicated to international commerce, and the inevitable adverse reaction of the non-U.S. signatories to the Convention (or *their* political subdivisions), will deal a severe blow to the smooth functioning of international cargo carriage. With respect to the United Kingdom in particular, such application will place undue burdens on U.K. shipping lines, and on the U.S. and U.K. customers (importers and exporters) of all shipping lines serving the trade between the U.S. and the U.K.

A ruling in favor of petitioner would remove a threat to the practice of trading nations for some 36 years during which Convention signatories have uniformly abided by the Convention's stricture to refrain from imposing taxes such as Tennessee's. Such a ruling would also reaffirm this Court's view that in regard to the United States the Convention "reflects a national policy to remove impediments to the use of containers as 'instrumentalities of international traffic.'" *Japan Line*, 441 U.S. at 453.

SUMMARY OF ARGUMENT

The Convention's prohibition on taxation applies to the political subdivisions of signatory nations just as forcefully as to the signatories themselves. The tax assessed by Tennessee on international container leases is covered by the plain terms of the Convention which proscribe all taxes whatsoever chargeable by reason of importation. The presence of a container in Tennessee is precisely

due to its temporary importation under the admissions standards of the Convention; that is, it is in Tennessee by reason of importation. Consistent with the dictates of the Convention, the United Kingdom and other nations have exempted from taxation the lease of temporarily imported international-commerce containers.

Throughout the existence of the Convention, no signatory nation has imposed national taxes on the lease of containers in international commerce, and until now no political subdivision of a signatory has done so. The uniform practice of signatories not to tax international container leases has been no mere coincidence; rather, it results from a common and reciprocal understanding of the Convention's reach. If the Convention were uniformly read the way Tennessee reads it, the leasing of international containers predictably would be burdened not only by Tennessee's tax but by other U.S. states' and nations' taxes. The United Kingdom and other signatories are not likely to tolerate a situation in which they refrain from imposing taxes on container leases due to their understanding of their Convention obligations, while a political subdivision of another signatory imposes its tax despite the Convention.

ARGUMENT

The Convention does not distinguish between national and subnational taxation. The phrase "all . . . taxes whatsoever" in Article 1(a) leaves no doubt that a tax contravening the Convention if imposed on a national level by a Contracting Party would also contravene the Convention if imposed by a political subdivision of a Contracting Party. The clear undertaking of each Contracting Party (including, of course, the United States) is that proscribed taxes are proscribed regardless of the level of taxation within a contracting state. This case is therefore different from *Wardair Canada, Inc. v. Florida Department of Revenue*, 477 U.S. 1 (1986), wherein this Court, after reviewing pertinent international agree-

ments, found that those agreements expressly prohibited only national sales taxes on aviation fuel and that in consequence the United States Government had "affirmatively decided to permit the States to impose these sales taxes on aviation fuel." *Wardair* at 12. There is no language in the Convention suggesting that its coverage is restricted to national taxation, nor is HMG aware of any other indicia of such restriction.

Only two general reasons—neither of which seems to rely on any argument that the Convention forbids only national taxes and not taxes imposed by political subdivisions—have been proffered in support of the proposition that the Convention does not preclude Tennessee's tax on international-commerce container leases: (1) that the Convention is inapplicable because it does not reach "the discrete transaction of the transfer of possession of leased cargo containers in Tennessee," [10] and (2) that the Convention relates only to customs duties on containers.[11] Neither of these reasons for escaping the reach of the Convention is valid in HMG's view, and both take an impermissibly narrow view of the Convention's scope.

As to the first, the Convention would be irremediably eviscerated by such reasoning since any aspect of international container commerce (the entry into a lease, payment of rent, acceptance of possession, utilization, and so on) could be characterized by a taxing authority as being discrete in order to avoid the Convention. The real question is whether a tax places a burden on the free flow of containers that the Convention is meant to ensure; Tennessee's tax plainly does.

The second reason simply ignores the unambiguous language defining the Convention's tax prohibition.

[10] Pet. App. at 16a; *accord*, Brief in Opposition to the Petition at 8 (filed Sept. 20, 1991) (hereinafter "Tenn. Br.").

[11] Amicus Curiae Brief for the United States at 9 (filed Jan. 23, 1992); Tenn. Br. at 7 ("[T]he Tennessee tax simply is not levied on imports, but is a generally applicable sales tax").

Rather, the Convention reaches broadly to embrace "not only Customs duties but also all duties and taxes whatsoever chargeable by reason of importation." Article 1(a).

International-commerce containers leased while in Tennessee are there precisely "by reason of importation," having entered the U.S. in the course of their continuous use in the cross-border commerce that the Convention is designed to facilitate. The presence of a marine container, for example, in Tennessee is due to its "temporary admission" into the United States under Article 3 of the Convention, which allows entry of a container into the territory of a Contracting Party for only a limited time (up to three months) before it once again embarks on a journey on the high seas *en route* to the territory of another Contracting Party. In other words, the container is in Tennessee only by reason of the fact that it has been imported as an international-commerce container, *i.e.*, "by reason of importation."

The fact that Tennessee's sales tax is assessed on the lease payments made for the container rather than on the container itself does not make the tax any more permissible under the Convention's terms or any less intrusive upon the declared purpose of the Convention. A transaction tax levied at any one point during the course of a container's journey in a continuous loop of international trade results in the same degree of interference with containerized commerce that would attend the assessment of a customs duty—which is why the Convention's drafters expressly prohibited "not only Customs duties" but any "taxes whatsoever chargeable" by reason of a container's temporary importation.[12]

Since its inception, the Convention has been consistently interpreted by the United Kingdom to prohibit the as-

[12] The burden that the tax imposes on international commerce is underscored by the fact that the tax is measured by the number of days that the container is leased for use in international commerce. In fact, a container so leased might well never again enter Tennessee (or any other state) during its lease term.

sessment of a tax such as that imposed by Tennessee on international-commerce containers temporarily imported into the United Kingdom. The United Kingdom's national analogue to Tennessee's sales tax is called the Value Added Tax ("VAT"). The VAT applies to the supply of most goods and services (including the service of equipment leasing) at a standard rate of 17.5%.[13] While the VAT is assessed against lease payments made for containers that are used in domestic commerce within the United Kingdom, with respect to *international*-commerce containers the United Kingdom has implemented the Convention to relieve them from the VAT.[14] Thus, HMG views the Convention as precluding the United Kingdom from imposing the 17.5% VAT in circumstances analogous to those under which Tennessee imposes its sales tax: on the leasing of containers dedicated to international commerce while those containers are in temporary import status in the United Kingdom under Convention rules.

The structure of United Kingdom VAT taxation is essentially the same in the other eleven nations of the European Community. The VAT system of taxation has been adopted by the European Community, which has laid down a set of principles intended to harmonize the tax laws of its member nations.[15] Each EC member state im-

[13] Value Added Tax Act 1983 and predecessor statutes.

[14] The temporary importation of leased containers into the United Kingdom under Convention admission rules is exempted from the VAT by virtue of HM Customs and Excise Notice 748 (Jan. 1, 1991); the export from the U.K. of leased containers is exempt from the VAT pursuant to Regulation 50, Value Added Tax (General) Regulations 1985, S.I. 1985 No. 886; and with respect to leased containers not physically present in the United Kingdom during the lease term, the VAT is not applicable by virtue of Schedule 5, Group 10, Item 11 of the Value Added Tax Act 1983. Similar exemptions have been applied in respect of the VAT and its predecessor tax since the U.K. became party to the Convention.

[15] Sixth Council Directive 77/388/EEC of May 17, 1977 (OJ No. L145, June 13, 1977) ("Sixth Directive").

poses the harmonized VAT and each is bound to implement an exemption from the VAT for international-commerce containers present in that member state under temporary importation arrangements.[16] Like the EC nations, other signatories to either the Convention or the 1972 Convention do not impose a national sales, use, VAT or similar tax on international container leases (insofar as HMG is aware), and until Tennessee did so, no political subdivision of a signatory assessed any such tax.

Those arguing that the Convention is not applicable to Tennessee's tax would have this Court believe that the uniform decision by the signatories of both Conventions to refrain from imposing national sales, use, VAT or similar taxes on international container leases is mere coincidence, not because the Conventions proscribe such taxation. That is not plausible. The long-standing and consistent practice of the signatory states in not imposing such taxation speaks persuasively, HMG believes, to the import and meaning of these multilateral Conventions. The Diplomatic Note transmitted to the Government of the United States by a number of governments, a copy of which is appended to this brief, underscores the point. The major overseas trading partners of the United States view Tennessee's assessment of tax as an unprecedented departure from the no-tax rule of the Conventions.[17]

Because the Convention does not distinguish between national taxes imposed by signatories and taxes imposed by their political subdivisions (as noted at the outset), the view that the Tennessee tax is of a type not covered by the Convention must necessarily mean that the national

[16] Article 14(1)(c), (i) and Article 15(13) of the Sixth Directive. It is the Convention, of course, that sets forth the multilateral regime for temporary admission; it is also the Convention which clearly speaks to the taxation of temporarily-admitted containers.

[17] The governments joining the attached Diplomatic Note are the Governments of Denmark, Finland, France, Germany, Italy, Japan, the Netherlands, Norway, Spain, Sweden and the United Kingdom.

imposition of such a tax would also fall outside the Convention's cover. It therefore seems to HMG that proponents of the propriety of Tennessee's tax believe that the United States could enact *federal* sales tax legislation applicable to international-commerce container leases without violating its Convention undertakings to other nations, a belief so directly at odds with the signatories' uniform practice of not imposing any national taxes on international container leases that it brings the central issue in this case into sharper focus. (Of course, if Tennessee's assessment is declared valid, other U.S. states with sales taxes would almost certainly also apply them in the same manner; that would be tantamount to a national sales tax in any event.)

HMG envisages that international chaos in container procurement, and consequent impairment of international trade, would result if all signatories felt themselves relieved of Convention restraints on taxation due to a major Contracting Party's position in respect of a tax assessed by one of its political subdivisions. The overlapping burdens resulting from taxation by numerous jurisdictions and the likelihood of retaliatory taxation of international container leases would impose a substantial price increase on leased containers that would jeopardize their utility as instrumentalities of international commerce. Container lessors, including U.K. lessors (of which there are a number) would suffer economic injury as the advantages of leasing are dissipated by widespread taxation (*e.g.*, shipping lines would opt for owned, rather than leased, container fleets). Moreover, permitting Tennessee to tax container leases despite the Conventions would open the door for other national and subnational jurisdictions to ignore the Conventions with regard to the imposition of myriad taxes on other aspects of international container commerce unrelated to leasing.

If the United States were now to interpret the Convention other than in the manner in which it has been

uniformly implemented for decades, the United Kingdom and other nations of similar persuasion are not likely to tolerate a situation in which they refrain from imposing taxes while U.S. political subdivisions impose theirs. The fundamental principle underlying any agreement among nations is reciprocity—here, a reciprocal understanding that there will be no taxation of the sort imposed by Tennessee. If such taxation is permitted in Tennessee's case, and reciprocity is thereby destroyed, the United Kingdom (and other signatories, HMG believes) would need to consider whether continued restraint from taxation, at least in relation to the United States, is warranted.

CONCLUSION

For the foregoing reasons, the Court should reverse the judgment of the Supreme Court of Tennessee.

Respectfully submitted,

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APPENDIX

The Governments of Denmark, Finland, France, Germany, Italy, Japan, the Netherlands, Norway, Spain, Sweden and the United Kingdom ("the Governments") present their compliments to the Department of State and have the honour to draw the attention of the Department of State to a case in the U.S. Supreme Court, *Itel Containers International Corporation v. Joe Huddleston, Commissioner of Revenue, State of Tennessee* (Case No. 91-321). This case involves a challenge to the imposition by the State of Tennessee of a sales tax on the proceeds earned from the lease of cargo containers used in international traffic when such containers are delivered in Tennessee. If this application of the Tennessee sales tax survives the challenge before the Supreme Court, container lessors under Tennessee law would be required to collect the tax (5.5% of the lease proceeds) from container lessees which typically are international shipping companies.

The Governments are gravely concerned by Tennessee's application of its sales tax to leases of containers in international commerce. Each of the Governments is signatory to either the 1956 Customs Convention on Containers (20 U.S.T. 301) or the 1972 Customs Convention on Containers (988 U.N.T.S. 43). The Government of the United States is party to both Conventions. The Governments are of the view that the application of Tennessee's sales tax to leases of international-commerce cargo containers is in direct contravention of the Government of the United States' undertakings in these Conventions. Consistent with obligations under the Conventions, neither the Governments nor any political subdivisions impose sales taxes (or equivalent taxes of different nomenclatures) on the lease of cargo containers that are used in international commerce among the Contracting Parties to the Conventions.

The taxation by Tennessee (and predictably by many other states in the future) of international-traffic con-

tainer leases would impose an unjustified and unacceptable burden on international shipping companies and their customers. The Governments consider that the purpose of the Conventions was to preclude any such burdens on international commerce. They would request the Department of State to bring the concern felt by the Governments about the incompatibility of the Tennessee tax with undertakings under the Conventions to the attention of all interested parties of the United States Government, including those who will be formulating the position of the United States in this regard.

The Governments avail themselves of this opportunity to renew to the Department of State the assurance of their highest consideration.

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SUMMARY OF ARGUMENT

The *amici* filing this brief support the position of petitioner Itel Containers International Corporation that the decision of the Tennessee Supreme Court upholding the application of the Tennessee sales tax to the lease of cargo containers used exclusively in international commerce and brought into the United States under customs bond is incorrect and should be reversed.

The application of the Tennessee tax in this context is preempted pursuant to the Supremacy Clause of the United States Constitution because it is in direct contra-

vention of the letter and spirit of two treaties to which the United States is a party, the Customs Convention on Containers, May 18, 1956, 20 U.S.T. 301, and the Customs Convention on Containers, December 2, 1972, 988 U.N.T.S. 43. The tax as applied frustrates the purpose of these Conventions and various implementing statutes and regulations, which was to promote and facilitate the use of containers in international commerce by, *inter alia*, freeing them from Customs duties and other duties, taxes, fees, and charges. Article 1(a), 988 U.N.T.S. at 44. The Tennessee tax, as applied, burdens not only container leasing companies such as the petitioner, it also burdens ocean carriers such as the members of the *amici* conferences that lease the containers for use in international commerce and that bear the ultimate burden of the tax.

The Tennessee tax is also preempted because it is inconsistent with a pervasive scheme of federal regulation of containers implementing the Customs Conventions. This regulatory regime exempts containers from customs duties that would otherwise be imposed and prescribes detailed standards and requirements for the admission of containers into the United States under customs bond.

The burden imposed on containers and containerized shipping in this case is comparable to the burden imposed on protected activities in other cases decided by this Court in which similar state taxes have been held to be preempted. *McGoldrick v. Gulf Oil Corp.*, 309 U.S. 414 (1940); *Xerox Corp. v. County of Harris, Tex.*, 459 U.S. 145 (1982).

In addition to the immediate burden of the Tennessee tax, if upheld it would open the door for the imposition of further burdens on containers and containerized shipping by other states and other countries who are signatories to the Customs Conventions but who do not currently tax container leases.

The *amici* also contend that the Tennessee tax as applied violates the Commerce Clause, Art. I, § 8, cl. 3, and

the Import-Export Clause, Art. I, § 10, cl. 3, of the United States Constitution. Those provisions are discussed in detail in briefs submitted by the petitioner and by other *amici* steamship industry interests. Accordingly, the *amici* Conferences support the analysis contained in those briefs, and will not address those provisions in detail herein.

INTEREST OF AMICI CURIAE

The *amici curiae* filing this brief are four conferences of ocean common carriers of cargo (hereinafter collectively referred to as the "Conferences"). The member carriers of the Conferences are permitted to discuss and agree upon matters of mutual interest in accordance with agreements filed with the United States Federal Maritime Commission pursuant to the Shipping Act of 1984, 46 U.S.C. app. § 1701 *et seq.* The Conference members include many of the largest United States and foreign flag liner carriers in the world, operating in major trades in the United States foreign commerce.[1] Their vessels are largely containerized and hence they utilize a large number of containers, some of which they own and some of which they lease.

As a result of the nature of their trade and business, as described above, the Conferences are concerned with the economic impact which the decision of the Tennessee Supreme Court will have on their operations in the foreign

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[1] The Conferences include a total of 21 ocean carriers based in 14 countries. Four of these carriers leased containers from Itel in Tennessee during the period relevant to this case. Itel Trial Exhibit 7. The members of the *amici* Conferences operate in the trades from the Far East (except Japan) to the United States (Asia North America Eastbound Rate Agreement), from the United States to the Mediterranean (U.S. Atlantic & Gulf Western Mediterranean Rate Agreement), from the Mediterranean to the United States (South Europe/U.S.A. Freight Conference), and from the United States to the United States to the Middle East (The "8900" Lines). A complete list of the Conference member carriers, and their nationality, is attached hereto as Appendix A.

commerce of the United States. In particular, the Conferences are concerned because they ultimately bear the brunt of the disputed tax. Although the incidence of the tax technically falls on the retailer (the lessor in this case), the Tennessee statute requires that the tax "shall be collected by the retailer from the consumer insofar as it can be done." Tenn. Code Ann. § 67-6-502 (1989). The cases construing this section make it clear that "the burden for the payment of the tax is meant to be that of the buyer." *Sam Carey Lumber Co. v. Sixty-One Cabinet Shop, Inc.*, 773 S.W.2d 252, 257, 260 (Tenn. Ct. App. 1989). *See also Hooten v. Carson*, 209 S.W.2d 273 (Tenn. 1948).

Thus, in practical terms, the effect of applying the Tennessee sales tax in this context will be to impose on ocean carriers such as the members of the Conferences, who lease containers for use in international commerce, a significant added cost of doing business in Tennessee. In addition, such a tax would likely cause them to lease containers in countries other than the United States whenever possible, diverting container business from the United States. Finally, the Conferences are also concerned that, if upheld by this Court, Tennessee's action likely will encourage other states [2] and other countries that do not currently do so to impose similar sales or other taxes on containerized shipping, further burdening their operations.

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[2] In most other states with sales taxes, the burden of the tax also falls on the consumer, in this case the lessee. *See, e.g.*, Cal. Revenue and Tax Code § 6203 (West 1987); New York Tax Law § 1132(a) (1988); Va. Code Ann. §§ 58.1-625 (1991); N.J. Stat. Ann. § 54:32B-14 (West 1986). Thus, to the extent other states follow Tennessee's lead, the financial burden on ocean carriers' containerized operations would correspondingly increase.

ARGUMENT

I. THE TENNESSEE TAX AS APPLIED TO THE LEASE OF CONTAINERS IS PREEMPTED BECAUSE IT FRUSTRATES THE PURPOSES AND OBJECTIVES OF CONGRESS IN RATIFYING AND IMPLEMENTING THE 1956 AND 1972 CUSTOMS CONVENTIONS ON CONTAINERS

Federal preemption of state statutes is rooted in the Supremacy Clause of the United States Constitution, Art. VI, cl. 2. Federal law may preempt state law either expressly or implicitly. *Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 152-153 (1982); *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977), *reh'g denied*, 431 U.S. 925 (1977). Absent express preemption, Congressional intent to preempt may be manifested in a number of different ways, including when there is a clear objective that is sought to be obtained by the federal law, when there is a pervasive system of federal regulation, or when the federal interest in an area is so dominant that it will be assumed to preclude enforcement of state law on the same subject. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947).

Of particular application in this case is the well-established principle that when a state tax or other law frustrates the purposes of federal regulation or stands as an obstacle to the accomplishment and execution of the purposes and objectives of Congress, it is pre-empted by virtue of the Supremacy Clause. *Hillsborough County v. Automated Mediterranean Laboratories Inc.*, 471 U.S. 707, 713 (1985); *Hines v. Davidovitz*, 312 U.S. 52, 67 (1941). The application of the Tennessee sales tax to the lease of containers moving exclusively in the foreign commerce of the United States frustrates a strong federal policy, rooted in two international treaties, of encouraging the type of international containerized transportation engaged in by the members of the Conferences

and to proscribe hindrances to, and burdens on, such transportation.

A. The Customs Conventions On Containers Were Designed To Promote And Facilitate Containerized Ocean Transportation

Two international conventions ratified by the United States directly govern the use of containers in international commerce, the Customs Convention on Containers, May 18, 1956, 20 U.S.T. 301 (the "1956 Convention"), and the Customs Convention on Containers, December 2, 1972, 988 U.N.T.S. 43 (the "1972 Convention"). The purpose of the Conventions was "to develop and facilitate international carriage by container . . . ." 1972 Convention, 988 U.N.T.S. at 44. See also, 1956 Convention, 20 U.S.T. at 304.

This purpose, as ratified and implemented by the United States, was reiterated by this Court in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979). There, the Court stated that the 1956 Convention "reflects a national policy to remove impediments to the use of containers as 'instruments of international traffic.'" *Id.* at 453. The Court stated that the 1956 Convention was implemented because of "[t]he desirability of uniform treatment of containers used exclusively in foreign commerce . . . ." *Id.* at 452.

After the 1956 Convention, there was a "considerable increase in numbers of containers used in international traffic," U.N. Doc. E. CONF. 59/2 (Feb. 22, 1971), at 1 (Note by the Secretariat). This development is generally referred to in the industry as the "container revolution." As technology developed, ocean carriers gradually shifted from "breakbulk" ships, where individual pieces of cargo were loaded on a vessel, to container ships, where cargoes are packed into containers, usually by the customer, and then the containers are moved on and off the vessel without having to handle individual

pieces of cargo. Containerization offers great cost savings to carriers in terms of labor and handling costs, which in turn results in greater efficiencies and reduced transit times for their customers. At the same time, it required huge capital investments in new ships and containers and related equipment. The benefits and efficiencies of containerization were discussed in detail by this Court in *NLRB v. International Longshoremen's Ass'n*, 447 U.S. 490, 495-496 (1980). *See also, Northeast Marine Terminal v. Caputo*, 432 U.S. 249, 270-271 (1977).

The container revolution resulted in the "need both for simplifying Customs formalities and facilitating container transport." U.N. Doc. E. CONF. 59/2 (Feb. 22, 1971), at 1 (Note by the Secretariat). Hence, the 1972 Convention was crafted. The purpose of the new Convention was, as stated by the United States in its comment on the draft 1972 Convention, to "contribute *significant economic benefits* to the development and facilitation of international container traffic on a global basis." U.N. Doc. E. CONF. 59/16 (Nov. 26, 1971), at 2 (emphasis added). Such economic benefits were necessary to induce ocean carriers to make the investments necessary to containerize their operations.

B. The Facilitation of Container Transportation Was To Be Accomplished In Large Part By Freedom From Taxation In Signatory Nations

To facilitate the international carriage of cargo by containers, the Conventions adopted the fiction of "temporary admission." This fiction is based on the simple concept that containers moving in international traffic do not enter the domestic stream of commerce of any of the signatory nations, and therefore are not subject to the burdens and responsibilities imposed on domestic commerce.

The primary mechanism provided under the Conventions to implement the temporary admission concept and

confer economic benefits on containerized transportation was freedom from fees and taxes relating to international containers. The Conventions provide that such containers should enter the signatory nations "free of import duties and taxes." Article 1(b) of the 1972 Convention, 988 U.N.T.S. at 44; Article 2 of the 1956 Convention, 20 U.S.T. at 304. This protection is limited to containers being used in international commerce, however. Containers temporarily admitted must be re-exported within three months of admission. 1972 Convention, Art. 4.1.

The protection from "import duties and taxes" was intended to be expansive. The term was defined in the 1956 Convention to mean "not only Customs duties but also *all* duties *and taxes whatsoever* chargeable by reason of importation." 1956 Convention, Article 1(a), 20 U.S.T. at 304 (emphasis added). This definition was broadened in the 1972 Convention to encompass ". . . Customs duties and *all other duties, taxes, fees and other charges* which are collected on, *or in connexion with*, the importation of goods . . . ." Article 1(a) of the 1972 Convention, 988 U.N.T.S. at 44 (emphasis added).

C. Tennessee's Imposition Of Sales Tax On Containers In International Commerce Frustrates Congressional Purpose And Is Thus Preempted

The imposition of a sales tax by the State of Tennessee on containers which are instruments of international traffic directly frustrates Congressional policy, as expressed in the Conventions and the federal statute and regulations implementing them, by placing significant economic burdens on containerized transportation. Economic burdens on protected activities or groups have been struck down by this Court in similar situations. The much-discussed case of *McGoldrick v. Gulf Oil Corp.*, 309 U.S. 414 (1940), is directly relevant to the current case.

In *McGoldrick*, the Court found that a New York sales tax levied on crude oil that had been imported in bond,

stored in bonded warehouses, and delivered to foreign-bound vessels in New York City was preempted by a federal scheme of statutes and regulations governing customs bonded warehouses. The Court found that the purpose of the federal scheme therein at issue was to enable American manufacturers to compete more favorably with their foreign competitors. *Id.* at 427. It further found that economic burdens on such manufacturers would frustrate that purpose if they detracted from the protections and advantages afforded by the federal regulation.

> The purpose of the Congressional regulation of the commerce would fail if the state were free at any stage of the transaction to impose a tax which would lessen the competitive advantage conferred on the importer by Congress, and which might equal or exceed the remitted import duties.

Id. at 429.

While *McGoldrick* spoke of taxes that "might equal or exceed the remitted import duty," 309 U.S. at 429, the subsequent case of *Xerox Corp. v. County of Harris, Tex.*, 459 U.S. 145 (1982) made it clear that any tax large enough "to *offset substantially* the very benefits Congress intended to confer by remitting the duty" would be preempted. *Id.* at 154 (emphasis added). *Xerox* involved the imposition by the city of Houston of *ad valorem* property taxes on copiers stored in a customs bonded warehouse. This Court held that the *Xerox* tax would frustrate the goal of Congress as reflected in its comprehensive federal scheme to encourage merchants here and abroad to make use of American ports as transshipment centers for goods in foreign trade.

In *Xerox*, the taxpayer paid taxes of $211,112, less than one-third of the $540,000 in customs duties that would have been due from Xerox had it been liable for such duties. 459 U.S. at 527-8 n.9. Nevertheless, the Court found that that burden was significant enough to frustrate the benefits intended to flow from the federal scheme. *Id.* at 527.

The Tennessee tax at issue in this case imposes a burden that nearly equals the potential import duties intended by the Conventions to be avoided. This is precisely the type of burden that was struck down in *McGoldrick* and *Xerox*. If Itel's containers had not been exempt from Customs duties, Itel would have had to pay approximately $178,550 in duties on its container fleet during the relevant period.[3] In comparison, Itel's assessment of sales tax during the period was $158,012, nearly the same amount. It is hard to imagine a fact situation that more closely corresponds with *McGoldrick* and *Xerox* than this one.

In its *amicus* brief opposing *certiorari* (Brief of the United States as *Amicus Curiae* at 9), the United States dismissed the application of the Customs Conventions because the taxes at issue are sales taxes, not customs duties. The State of Tennessee makes a similar argument in its response to the *certiorari* petition. This narrow reading is directly contrary to prevailing case law.

The *McGoldrick* and *Xerox* cases make it clear that preemption may occur if the federal scheme is frustrated even if, as here, the tax is not the specific type of tax prohibited in the statutory scheme. It is instructive that in *McGoldrick*, Congress relied on federal statutes and regulations that prohibited the imposition of *import duties* on bonded fuel and other materials. However, the tax struck down was not an import or customs duty, it was a sales tax. Thus, *McGoldrick* firmly established the principle that a comprehensive federal scheme may protect not just against the type of tax or duty specified, but also against any other type of tax on the protected

[3] During the period, containers that were not used in international commerce were subject to a duty of anywhere from 0.6% to 2.5% of the value of the goods during the relevant period. TSUS 640.30. The replacement value of Itel's container fleet during the relevant period can be estimated at $11,109,172. Stipulation 92, Trial Ex. 7, 13, 15, 22. Based on this, the duty on those containers, at the above rates, would have been $178,550.

activity which would have a comparable burdensome effect on the activity. The same principle applies in this case.

In any event, however, the protections of the Conventions are not limited strictly to Customs duties. As discussed at pages 9-10 *supra*, the duties prohibited by the Conventions have been broadly defined to include "all other duties, taxes, fees and other charges" imposed "in connexion with" or "by reason of" importation of goods.

The Tennessee sales tax as applied here falls squarely within these prohibitions. By their nature, containers in international commerce typically enter the country with an import load and are then loaded for export.[4] Thus, the containers taxed will in most cases carry a load of imported goods into the United States at or near the time of the tax. The record indicates that 61% of the Itel containers subjected to tax in this case were subsequently used in a United States import move during the lease period. Itel Trial Exhibits 3, 7, 13, and 15. Because these are bonded international containers, it is likely that virtually all the containers originally moved to Tennessee either directly or indirectly from another country, *i.e.*, through an import move. Thus, importation is the very reason the containers are in the United States and the reason they are leased by ocean carriers, thereby becoming subject to the Tennessee tax.

That the Tennessee tax as applied to containers is a "tax . . . chargeable by reason of importation," or "in connexion with importation" is further evidenced by the fact that it is measured as a percentage of the gross proceeds of the lease during the lease period. Tenn. Code

[4] There is a clear demarcation line between the international containers at issue in this case and containers moving in United States domestic commerce. Bonded containers lose their protection from customs duties if they are used in domestic commerce. 19 C.F.R. § 113.66(a). In addition, they lose their treaty protections if they remain in the United States for more than three months without being reexported. 1972 Convention, Article 4.1, 988 U.N.T.S. at 45.

Ann. § 67-6-204. In this case, Itel's containers were leased on a *per diem* basis, which is the common lease term in the industry. In other words, the more they are used in international commerce during the lease period, the greater the amount of the tax.

Ocean carriers have a strong economic incentive to move containers as rapidly as possible. This means that for the containers leased by Itel, or those leased in any other state, the time spent in the leasing state will generally be a small fraction of the time consumed by the international move as a whole. Accordingly, although the State of Tennessee may assert that the tax is imposed merely on an event that occurs solely within the state, in practice it is imposed on containerized transportation that occurs almost entirely outside the state and that occurs exclusively in international commerce.

The fact that none of the other countries which are signatories to the Conventions impose sales taxes on the lease of containers in their country is further strong evidence that they construe the Conventions to prohibit these types of taxes. It also indicates that such construction reflects the intent and understanding of the parties when entering into the Conventions. For example, the United Kingdom specifically exempts from the Value Added Tax leases of both export and import containers. VAT (General) Regulations 1985, Regulation 50; HM Customs and Excise Notice 748 (Jan. 1, 1991).

D. The Tennessee Tax Burdens The Activities of The Companies That Distribute and Use Containers

The burden the Tennessee tax, as applied, places on (i) the container leasing companies that provide many of the containers covered by the Conventions, and (ii) ocean carriers such as the members of the *amici* Conferences that use containers in their international containerized shipping operations, demonstrates how the tax frustrates the federal purpose of facilitating containerized transportation. The Tennessee tax burdens these entities in a number of critical ways.

First, the tax places an obvious burden on the companies, such as Itel, that lease containers in the United States. To the extent they cannot collect the tax from their lessee customers, they will pay significant amounts in taxes and will incur significant administrative expenses in processing the tax and tax monies.

In addition, the leasing companies will be placed at a competitive disadvantage vis-a-vis their foreign competitors that lease containers in other countries, such as the EEC countries, where a tax is not imposed on container leases by the country or any subnational unit. The absence of a tax in such countries would provide an incentive for carriers and other lessees to procure their containers outside the United States, causing the American companies to lose business. It could even cause those companies, to the extent they could, to shift their operations more heavily to countries in which no tax is applied in order to allow their customers to escape the tax. Since the lessees of these containers by definition operate between the United States and foreign countries, they would in most cases be able to lease containers on the other side of the ocean.

Taxation of containers also imposes significant burdens on containerized ocean carriers. As noted at pages 4-5 *supra*, the Tennessee tax requires that the tax be passed on to the consumer, in this case the lessee. Thus, carriers will be taxed for engaging in the very activity that is intended to be protected under the Conventions. This is contrary to the purpose of the Customs Conventions, which was to "contribute significant economic benefits" to facilitate "container traffic on a global basis." Economic benefits to a protected activity or group are a well-recognized basis for federal preemption protection. *McGoldrick*, *supra*, 309 U.S. at 426-27.

The burdens on carriers and leasing companies are significant because those entities are entitled to protec-

tions under the Conventions and the federal regulatory scheme. The Tennesse Supreme Court erred when it concluded that this Court in *Japan Line* found "no Congressional intent to benefit container companies in the statutes regulating cargo containers." *Itel Containers Int'l Corp. v. Charles E. Cardwell, Commissioner of Revenue, Tenn.*, 814 S.W.2d 29, 44 (Tenn. 1991). It is hard to imagine what the Tennessee court believes Congress intended to protect by ratifying the Customs Conventions and by enacting broad based container regulations if not container leasing companies and containerized carriers. Treaties and statutes do not generally protect or promote mere objects, they generally also promote activities or groups.

In this case, it is clear that the Conventions were intended to protect not only containers, but also to "contribute significant economic benefits to the development and facilitation of international container traffic on a global basis," U.N. Doc. E. CONF. 59/16 (Nov. 26, 1971) at 24. Economic benefits redound to the parties carrying out the container transportation, such as the Conference members, not to the containers themselves.[6] In this case,

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[6] Economic benefits, whether conferred by a treaty or a statute, are often used as tools of federal regulatory policy to encourage or discourage an activity. A prime example is the tax deduction, which fosters such Congressionally-endorsed policies as home purchasing and charitable donations. See, *Graham v. Commissioner*, 822 F.2d 844, 852 (9th Cir. 1987), *aff'd sub nom. Mennendez v. Commissioner of Internal Revenue*, 490 U.S. 680 (1989), *reh'g denied*, 492 U.S. 933 (1989) (citing charitable deductions' "objective of aiding education, science, and literary pursuits, and religion, an end that has become a central feature of national tax policy"); Klein, Bittker, and Stone, FEDERAL INCOME TAXATION (7th ed.) at 457.

At the same time, taxes or duties are also a form of regulation. As this Court has stated, "[t]he laying of a duty on imports, although an exercise of the taxing power, is also an exercise of the power to regulate foreign commerce . . . ." *McGoldrick*, 309 U.S. at 428, *citing, Hampton, Jr., Co. v. United States*, 276 U.S. 394, 411 (1928).

the Conventions and federal regulations were designed to promote and encourage the containerized transportation of goods in international commerce by carriers by effectively subsidizing that transportation through abatement of taxes in connection with importation activities.

E. The Threat Of Retaliation Magnifies The Burden Imposed By The Tennessee Tax

The economic burden imposed by Tennessee on leasing companies and carriers is amplified by the risk that other states, in an effort to increase revenues, might follow Tennessee's lead if this tax is upheld. This would greatly increase the burden on containerized transportation, particularly if Tennessee's lead were followed in port states where many more containers are leased than in Tennessee.

The frustration of federal purpose is further increased in this case by the risk that other countries might seek to retaliate against the United States by imposing similar taxes. As this Court recognized in *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, *reh'g denied* 464 U.S. 909 (1983) "[t]he most obvious foreign policy implication of a state tax is the threat it might pose of offending our foreign trading partners and leading them to retaliate against the Nation as a whole." *Id.* at 194. Such retaliation would clearly frustrate the purpose of the Conventions, which was to develop and facilitate container traffic "on a global basis." U.S. Doc. E. CONF. 59/16 (Nov. 26, 1971) at 2. International comity was a major goal of the United States in entering into the Conventions. The White House's letter transmitting the 1972 Convention to the Senate states:

> This Convention is important because it will insure United States-owned containers the same treatment in the territories of States parties to this Convention as that afforded in the United States to foreign-owned containers.

President's Message to Senate Transmitting Advice and Consent, November 14, 1973.

The possibility of retaliation is not wholly speculative. The Conferences understand that the United Kingdom, an *amicus curiae* in this case, has indicated that if Tennessee's application of a sales tax on international containers is upheld it would have to reevaluate its own forebearance of taxation of such containers. This demonstrates that the threat of retaliation is real and could defeat the Conventions' stated purpose of facilitating container transportation throughout the world.

II. THE TENNESSEE TAX IS PREEMPTED BECAUSE IT IS CONTRARY TO A PERVASIVE FEDERAL SCHEME OF REGULATING CONTAINERS

The Tennessee tax is also pre-empted because it frustrates the pervasive scheme of federal regulation of containers. It is well-established that state laws that intrude into an area of pervasive federal regulation cannot stand. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947) This principle applies equally to federal regulations as to federal statutes. *Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 154 (1982); *Louisiana Public Serv. Comm'n v. FCC*, 476 U.S. 355, 370 (1986).

In its opinion (814 S.W.2d at 42), the Tennessee Supreme Court sought to downplay the pervasiveness of the federal regulation of containers cases by comparing the Customs Service regulations on containers with the bonded warehouse regulations at issue in the *McGoldrick* and *Xerox* cases. This distinction is incorrect. The container regulations are indeed pervasive.

Largely for the purpose of implementing the Conventions, Congress and the Executive Branch have created a comprehensive federal scheme to facilitate the movement of containers in foreign commerce. The Secretary of the Treasury has, pursuant to authority conferred on him by

19 U.S.C. § 1322(a), designated containers as "instruments of international traffic." 19 C.F.R. § 10.41a (a)(1), (3). Consequently, containers are free from the application of the Customs laws as long as assurances are provided by the owner that they will not be used in U.S. domestic commerce. To secure compliance with these representations, the owner must post a continuous bond with the U.S. Customs Service. 19 C.F.R. § 10.41a(a), (c); § 113.66. There is also a scheme of federal regulations which provides the requisite procedures for the certification and approval of containers moving under Customs seal. 19 C.F.R. § 115.

The Tennessee Supreme Court distinguished the Customs regulations from the bonded warehouse regulations, among other things, on the grounds that "[c]argo containers are neither under the supervision nor in the custody of customs officers." 814 S.W.2d at 42. This does not mean the regulation of containers is not pervasive. Obviously, containers cannot be in the physical control or custody of customs officers because of their nature and function as vehicles of international transportation.

However, the containers are effectively under the control and supervision of the Customs Service. At all times they move under Customs bond and are subject to the requirements and penalties provided for in that bond. For example, if a container operator defaults on the terms of its bond, it must pay liquidated damages equal to the value of the merchandise. 19 C.F.R. § 113.66(c). If, for any reason, such bonded containers enter domestic commerce in any manner, they are subject to the ordinary incidence of taxes, charges, and duties, including import duties, and would no longer be subject to the regime of the Conventions and regulations and would no longer benefit from the protections that regime affords. 19 C.F.R. § 113.66(a). Thus, while somewhat different from the bonded warehouse regulations, the customs scheme is no less pervasive.

Moreover, pervasiveness is not the only grounds for federal preemption and is not an essential element of preemption. It is only one of a host of factors that each independently justify preemption. The primary grounds for the holding in *McGoldrick* was the frustration of Congressional purpose, not pervasiveness of the warehouse regulations. The comprehensive federal regulatory scheme was only one factor in determining the Congressional purpose. In *Jones v. Rath Packing Co.*, 430 U.S. 519 (1977), *reh'g denied*, 431 U.S. 925 (1977), this Court held that state regulation of weight information on packaged foods was preempted by the federal Fair Packaging and Labeling Act even though there was no holding that the federal scheme was pervasive, and despite the fact that the California requirement at issue was "not inconsistent with federal law." *Id.* at 541. There, the California requirements were struck down because they stood as an obstacle to the FPLA's purpose "to facilitate value comparison among similar products." *Id.* at 542.

Thus, even federal legislation that is not pervasive will preempt state statutes or regulations if they frustrate Congressional purpose or satisfy another of the tests of federal preemption. Cf. *Hines v. Davidovitz*, 312 U.S. 52 (1941); *Mite Corp. v. Dixon*, 633 F.2d 486, 491 (7th Cir. 1980), *aff'd* 457 U.S. 624 (1982).

CONCLUSION

For all the foregoing reasons, this Court should rule that the imposition of the Tennessee sales tax on containers which are instruments of international traffic is preempted pursuant to the Supremacy Clause of the United States Constitution because it frustrates important national purposes and policies expressed in the 1956 and 1972 Customs Conventions, as ratified and implemented by the United States, and is contrary to the pervasive federal statutory and regulatory scheme implementing those policies.

Respectfully submitted,

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April 30, 1992

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APPENDIX A

Names and Nationalities of
Ocean Carrier Members of Amici Conferences

Asia North America Eastbound Rate Agreement

American President Lines, Ltd. (USA)
Kawasaki Kisen Kaisha, Ltd. (Japan)
A.P. Moller-Maersk Line (Denmark)
Mitsui O.S.K. Lines, Ltd. (Japan)
Neptune Orient Lines, Ltd. (Singapore)
Nippon Yusen Kaisha Line (Japan)
Orient Overseas Container Line, Ltd. (Hong Kong)
Sea-Land Service, Inc. (USA)

South Europe/U.S.A. Freight Conference

Achille Lauro (Italy)
Compagnie Generale Maritime (France)
Compania Trasatlantica Espanola, S.A. (Spain)
Evergreen Marine Corporation (Taiwan) Ltd. (Taiwan)
Farrell Lines, Inc. (USA)
"Italia" di Navigazione, S.p.A. (Italy)
Lykes Bros. Steamship Co., Inc. (USA)
A.P. Moller-Maersk Line (Denmark)
Nedlloyd Lines (Nedlloyd Lijnen B.V.) (The Netherlands)
Sea-Land Service, Inc. (USA)
P&O Containers Limited (U.K.)
Zim Israel Navigation Company, Ltd. (Israel)

The "8900" Lines

A.P. Moller-Maersk Line (Denmark)
National Shipping Company of Saudi Arabia (Saudi Arabia)
Sea-Land Service, Inc. (USA)
United Arab Shipping Company (S.A.G.) (Kuwait)
Waterman Steamship Corporation (USA)

U.S. Atlantic & Gulf/Western Mediterranean Rate Agreement

Compagnie Generale Maritime (France)
Compania Trasatlantica Espanola, S.A. (Spain)
Evergreen Marine Corporation (Taiwan) Ltd. (Taiwan)
Italia di Navigazione, S.p.A. (Italy)
Lykes Bros. Steamship Co., Inc. (USA)
Nedlloyd Lines (Nedlloyd Lijnen B.V.) (The Netherlands)
P&O Containers Limited (U.K.)
Sea-Land Service, Inc. (USA)
Zim Israel Navigation Company, Ltd. (Israel)

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No. 91-321

IN THE
Supreme Court of the United States
OCTOBER TERM, 1991

ITEL CONTAINERS INTERNATIONAL CORPORATION,
Petitioner

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE,
STATE OF TENNESSEE,
Respondent

On Writ of Certiorari to the Tennessee Supreme Court

BRIEF OF THE INSTITUTE OF INTERNATIONAL CONTAINER LESSORS, CRONOS CONTAINERS, FLEXI-VAN LEASING, INC., GENSTAR CONTAINER CORP., TEXTAINER EQUIPMENT MANAGEMENT (U.S.) LTD., TRANS OCEAN LTD., TRANSAMERICA LEASING INC., TRITON CONTAINER INTERNATIONAL LTD., SEA CONTAINERS LTD., CLOU CONTAINER LEASING GMBH, AND MATSON LEASING COMPANY AS AMICI CURIAE IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

The question amici will address corresponds to Question 1 in the petition for a writ of certiorari:

> Whether the Foreign Commerce Clause precludes the imposition of a state sales tax on the entire lease proceeds of containers that are only briefly present in the State during the course of international transit?

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-321

ITEL CONTAINERS INTERNATIONAL CORPORATION,
Petitioner

v.

JOE HUDDLESTON, COMMISSIONER OF REVENUE,
STATE OF TENNESSEE,
Respondent

On Writ of Certiorari to the Tennessee Supreme Court

BRIEF OF THE INSTITUTE OF INTERNATIONAL CONTAINER LESSORS, CRONOS CONTAINERS, FLEXI-VAN LEASING, INC., GENSTAR CONTAINER CORP., TEXTAINER EQUIPMENT MANAGEMENT (U.S.) LTD., TRANS OCEAN LTD., TRANSAMERICA LEASING INC., TRITON CONTAINER INTERNATIONAL LTD., SEA CONTAINERS LTD., CLOU CONTAINER LEASING GMBH, AND MATSON LEASING COMPANY AS AMICI CURIAE IN SUPPORT OF PETITIONER

INTEREST OF THE AMICI CURIAE

With the consent of the parties pursuant to Rule 37 of the Rules of this Court, the amici curiae submit this brief in support of petitioner.

The amici curiae are firms primarily engaged in the business of leasing marine cargo containers to international shipping lines for use in the worldwide transportation of goods. Together, the amici represent more than 95 percent of the United States container leasing industry. Six of the amici are incorporated in the United States, two in Bermuda, one in the United Kingdom, and one in Germany. Seven belong to the Institute of International Container Lessors, the trade association for the international container leasing industry.

The decision below threatens to injure the international container leasing industry by shattering the longstanding global understanding that containers are not subject to sales, use or similar transaction taxes. It also permits a tax on the entire rental proceeds of a container lease even though the container is only temporarily located in a State during the course of its international journey. Other States will inevitably follow Tennessee's lead and adopt the politically attractive and lucrative means of taxing the lease proceeds of containers passing through their territories. Similarly, foreign nations will be induced to apply their own taxes to containers flowing through their borders. The end result will be to subject container leases to wholly disproportionate and duplicative taxes. Such taxes will substantially impair the international transport of goods by eviscerating the economic advantages associated with container leasing.

Because amici would be critically affected by a decision allowing States to impose sales, use or similar transaction taxes on the lease of marine cargo containers, their view on the constitutionality of such taxes may be of substantial assistance to the Court's consideration of this case.

STATEMENT

The particular facts of this case are stated in the petitioner's brief and are not repeated here. Instead, this section gives an overview of those aspects of the international container leasing industry necessary to resolve the issues in this case.

I. THE NATURE AND OPERATION OF THE INTERNATIONAL CONTAINER LEASING INDUSTRY

"One of the most important technological developments in the transportation of goods by sea since steam replaced sail is the advent of the 'container revolution.'" Simon, *The Law of Shipping Containers*, 5 J. Mar. L. Com. 507, 507 (1974). Containers are specially manufactured boxes, usually made of steel, typically 20 or 40 feet long, 8 feet wide, and 8.5 or 9.5 feet tall, that are used to transport goods by ship. Containers are not merely packages to contain goods, but are "permanent, reusable article[s] of transportation equipment." *Id.* at 513. Although containers are intermodal, that is, they can travel equally well by ship, behind a tractor over the road, or on a railroad flat car, they are principally considered to be marine instruments, since virtually every trip made by the typical container involves a sea voyage.

Although containers were first used by shipping lines in the 1950s, the leasing of containers became an important activity during the 1960s. See *Trends in International Taxation* 18 (Organization for Economic Cooperation and Development 1985). The international leasing industry greatly facilitates, and reduces the cost of, the international transport of goods by providing a pooling mechanism that efficiently manages the distribution of containers to shipping lines. Thus, the container leasing industry performs "an important service for the world transportation system." *Ibid.*

Today, containers are the principal means for marine transportation of manufactured products and also play a significant role in ocean transport of raw materials and agricultural products. The current world fleet of containers is approximately 6.7 million TEU.[1] Almost half of

[1] TEU stands for twenty-foot equivalent units. One twenty-foot container equals one TEU; one forty-foot container equals two TEU.

that fleet is owned by leasing companies, with international shipping lines owning the other half. U.S. domiciled companies—including shipping lines and leasing companies—own approximately 37 percent of all containers. See *Cargoware International*, Dec. 1990, at 7. The U.S. container leasing industry—which is the largest in the world—accounts for over 25 percent of the world's containers. *Ibid.* More than 85 percent of the revenues of the U.S. container leasing industry is derived from rentals to shipping lines domiciled in foreign countries.

There are several different types of container leasing arrangements, including short-term (generally six months or less), long-term (generally one to five years), and master lease agreements. Master lease agreements provide lessees with the opportunity to pick up containers at certain ports throughout the world and to drop off containers at other designated ports. In addition, they set the general contract terms and conditions that will apply to all future leases during the agreement period. When containers are picked up under a master lease agreement, there is usually no set period for their return.

Whatever the type of lease, the lessee determines the containers' route of travel, the maximum length of the lease, and at which drop off point the container will be delivered at the close of the lease term. While leases last on average at least a year, they often last as long as five years. Leases usually impose a rental charge on a per diem, or daily rate basis, but are typically billed on a monthly basis. Because lease terms are frequently open-ended and are often renewed, the length, and therefore the entire proceeds, of a lease cannot usually be determined until the ultimate return of a container.

The leasing industry (and thus the international shipment of goods) is facilitated by a worldwide system of depots at which international shipping lines pick up, re-

turn, and reposition containers.[2] Today, there are approximately 500 depots around the world in more than 40 countries. *Containerization International Yearbook* 528-542 (1992). In the United States, there are more than 100 depots in more than 20 States. Although a very few depots are owned and operated by leasing companies, the vast majority are owned and operated by independent enterprises, which serve numerous container leasing companies, as well as other ventures, including shipping lines and truckers. They are usually run by local businessmen who pay property, income and other applicable taxes in operating their businesses.[3]

Containers are in the stream of international commerce for the entire period of their lease. They "engage in no intrastate or interstate transportation of cargo except as continuations of international voyages. * * * Any movements or periods of nonmovement of containers * * * are essential to, and inseparable from, the containers' efficient use as instrumentalities of foreign commerce." *Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. 434, 437 (1979). As virtually all containers are manufactured abroad—largely in the Far East—containers typically begin their journey in a foreign country. Thus, they usually enter the United States transporting goods from other countries.

In the United States, leases generally begin when a shipping line needs a container to export goods overseas. After sending a trucker to pick up an empty container at

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[2] Occasionally, the leasing companies will reposition the containers themselves when particular depots build up surpluses or shortages.

[3] Neither the lessor nor the lessee of a container is usually domiciled, or even has a marketing office, in the State in which the container is picked up pursuant to a lease. Nor is the lease typically solicited, negotiated or executed in such a State. Indeed, leasing companies typically maintain only a handful of marketing offices in the United States.

a depot, the lessee will transfer it immediately to a manufacturer to be loaded with goods, and then to a port for travel overseas. Often the manufacturer is located out of state; in that case, the container will stay in the depot state for no more than a day after being picked up by the lessee. If the manufacturer is located in the depot state, the container will usually remain in the State for less than a week before being transferred to the port. While a container delivered pursuant to a lease in the United States will initially be used to export American goods to foreign ports, it will subsequently be used in myriad other import-export shipments, spending the majority of its time overseas.

II. THE REGULATION OF CONTAINERS AS INSTRUMENTALITIES OF FOREIGN COMMERCE

Because of their status as instrumentalities of foreign commerce, containers are subject to a series of international treaties, federal laws, and regulations. The most relevant treaties are the 1972 Customs Convention on Containers, 988 U.N.T.S. 43, and the 1956 Customs Convention on Containers, 20 U.S.T. 301, which seek to facilitate the international shipment of goods by exempting containers from customs duties and other taxation.[4] The 1972 Convention requires all signatory nations, including the United States, to grant "temporary admission to containers, whether loaded with goods or not." Art. 3, 988 U.N.T.S. at 45. "Temporary admission" is defined to mean "temporary importation, subject to reexportation, free of import duties and taxes and free of import prohibitions and restrictions." Art. 1(b), *id.* at 44. The term "import duties and taxes" is broadly defined to "mean Customs duties and *all other* duties, taxes, fees and other charges which are collected on or in connexion with, the importation of goods." Art. 1(a), *id.* at 44 (emphasis supplied). The Convention requires strict compliance with a number of regulations, including a restriction on the use of the containers in domestic traffic (art. 9, *id.* at 46; annex 3, *id.* at 52), and a general requirement of reexportation within three months from the date of importation (art. 4, *id.* at 45), to qualify for these benefits.[5]

[4] In addition to the Customs Conventions, the United States has entered into the International Convention for Safe Containers, 29 U.S.T. 3707, 1064 U.N.T.S. 3, which establishes safety standards for containers.

Pursuant to the 1972 Convention and its predecessor, the 1956 Convention, the United States has promulgated a number of regulations governing containers. Upon their arrival in the United States, containers are registered with the Customs Service as "instruments of international traffic" that are exempt from the customs laws, including the payment of customs duty so long as they are used solely in international commerce. 19 C.F.R. §§ 10.41a(a)(1), (3) and § 10.41a(f) (1991). Upon entry of containers into the United States, their owners must post a continuous bond with the Customs Service to cover all duties, taxes or liquidated damages that could be assessed in the event of a container's unlawful use in intrastate or interstate commerce. 19 C.F.R. § 10.4a(c) (1991). Once a container becomes unsuitable for use, the owner is required to file notification with the Customs Service in order to remove it as an instrument of international traffic. See 19 C.F.R. 10.41(e) (1991). The company then typically resells the container for scrap or domestic use.[6]

[5] Because of the limited space granted amici, this brief does not specifically address the 1956 Convention. But the same arguments made with respect to the 1972 Convention apply with equal force to the 1956 Convention.

[6] A tiny fraction of containers has been "domesticated" for use in interstate commerce. Containers are not generally used for domestic commerce simply because it is less expensive to ship goods by ordinary tractor/trailer truck than by container, if a trip does not involve a sea voyage.

III. THE APPLICATION OF TENNESSEE'S SALES TAX TO CONTAINERS USED EXCLUSIVELY IN FOREIGN COMMERCE

The tax at issue in this case was imposed under the Tennessee Retailer's Sales Tax Act, which imposes a 5.5 percent tax on tangible personal property sold in the State. Two provisions of the Act are applicable to container leases. First, the Act declares that "every person is exercising a taxable privilege who engages in the business of selling tangible personal property at retail in this state * * * or who rents or furnishes any of the things or services taxable under this chapter [or who] leases or rents property, either as lessor or lessee, within the state of Tennessee." Tenn. Code Ann. § 67-6-201 (1989). Second, Tennessee includes the term "lease or rental" within the statutory definition of the term "sale." Specifically, it defines a "sale" as "any transfer of title or possession, or both, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatsoever of tangible personal property for a consideration." *Id.* § 67-6-102(23)(A).

The Supreme Court of Tennessee found that the foregoing provisions apply to leases of containers delivered in Tennessee because they manifest "the legislature's intent to tax the transfer of possession of tangible personal property in Tennessee, pursuant to lease agreements executed outside of Tennessee." *Itel Containers Int'l Corp.* v. *Cardwell*, 814 S.W.2d 29, 31 (1991). Because Tennessee's sales tax is triggered by the mere transfer of possession in Tennessee, the Court found that it applies to container leases despite the fact that "[t]he interruption of movement in Tennessee [i]s not for the purpose of any use of the Containers prior to the continuation of international movement." Statement of Stipulated Facts ¶ 78.

The measure of Tennessee's sales tax on the lease of containers delivered in its jurisdiction is the gross proceeds of the lease over its entire term. See Tenn. Comp. R. & Regs. tit. 18, ch. 1320-5-1.32(1) (1991). A container lessor is required to pay the tax "on a billing basis, either on the lump sum at the time of execution, or on a monthly or periodical basis as provided in the contract." *Id.* ch. 1320-5-1.32(2). Thus, because container leases are generally billed on a monthly basis, lessors that deliver containers in Tennessee will be required to submit a tax to the State each month for as long as the lease continues. While the legal incidence of the tax falls on the container lessor, state law provides that the tax must be separately stated on the bill submitted to the lessee and "shall be collected by the retailer from the consumer insofar as it can be done." Tenn. Code Ann. § 67-6-502 (1989). Lessors must continue to collect such taxes from lessees even though the container leaves Tennessee and never enters the State again.[7] Accordingly, if a lessee picks up a container in Tennessee and then uses it for the next three years to transport goods solely between Yokahama and Sacramento, each monthly payment on the lease for those three years will be subject to Tennessee's sales tax even though the container never again enters Tennessee.

The imposition of Tennessee's sales tax on the gross proceeds of container leases appears to be the first application of its kind. Amici are aware of no other State or foreign nation that has attempted to apply a sales, use or similar transaction tax to containers used solely in international commerce.

SUMMARY OF ARGUMENT

The imposition of a sales or similar transaction tax on the gross proceeds of container leases violates three specific provisions of the Constitution, namely, the Commerce

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[7] See Tenn. Comp. R. & Regs. tit. 18 ch. 1320-5-1.32(2) (1991) ("The Sales Tax shall apply to all leases of tangible personal property delivered to a lessee or rentee in this State, regardless of where the property will be taken or used by the lessee or rentee, whether within or without the State of Tennessee.").

Clause (Art. I, § 8, Cl. 3), the Supremacy Clause (Art. VI, Cl. 2) and the Import-Export Clause (Art. I, § 10, Cl. 2). Given the substantial overlap of the arguments under these three Clauses, as well as the limited space allotted to amici, this brief specifically addresses only the Commerce Clause violation. Amici fully agree, however, with the arguments presented in petitioner's brief pertaining to the other two constitutional violations.

To begin with, Tennessee's tax flagrantly violates the Commerce Clause test articulated by this Court in *Japan Line* by creating a substantial risk of international multiple taxation—one of the primary evils the Commerce Clause was designed to prevent. 441 U.S. at 451. Because containers travel through numerous foreign countries, other jurisdictions have equal opportunity to tax the same container lease proceeds taxed by Tennessee. To date, they have adhered to the long-established understanding that container leases should be free from taxation. If the Tennessee tax is upheld, however, these jurisdictions will surely respond with duplicative taxes. Given the absence of any central international body able to prevent such double taxation, neither Tennessee—nor any other State—can be permitted to impose a tax on the lease of containers used exclusively in international commerce.

Tennessee's tax also runs afoul of the Commerce Clause by preventing the federal government from "speaking with one voice" in the area of foreign relations. *Ibid.* Under the ruling below, each State would be able to interfere with one of the cornerstones of international relations: the free passage of instrumentalities of foreign commerce through the borders of the international community of nations. This interference would place the United States in direct violation of its treaty obligations under the Customs Convention on Containers, and would inevitably lead to foreign retaliatory measures against not only Tennessee, but the nation as a whole. That the risk of retaliation is a real one is demonstrated by the

recent formal objection to Tennessee's tax lodged with the U.S. Department of State by eleven foreign countries. Reversal of the decision below is therefore necessary to ensure that individual States and localities will not become hopelessly and dangerously enmeshed in international trade and taxing disputes to the detriment of the entire country.

Finally, Tennessee's tax transgresses the Commerce Clause because it is not fairly related to the services provided by the State and because Tennessee lacks a sufficient nexus to tax containers merely delivered in its jurisdiction. *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 279 (1977). These conclusions follow from the fact that Tennessee's tax applies to the entire proceeds of container leases notwithstanding that (1) containers spend the vast majority of the lease terms outside of Tennessee; (2) lessors typically have no contact with the State beyond the mere delivery of containers in its borders; and (3) transfers are "not for the purpose of any use of the Containers prior to the continuation of international movement" (Statement of Stipulated Facts ¶ 78). While Tennessee may be permitted to apply its sales tax to leased property used in domestic commerce, the special qualities of containers plainly preclude it from taxing the entire lease proceeds of containers used exclusively in foreign commerce.

ARGUMENT

I. A STATE TAX ON THE ENTIRE LEASE PROCEEDS OF CONTAINERS USED EXCLUSIVELY IN FOREIGN COMMERCE VIOLATES THE COMMERCE CLAUSE

Because containers are "instrumentalities of foreign commerce," Tennessee's tax must satisfy both the *Japan Line* and *Complete Auto* tests in order to pass muster under the Commerce Clause. *Japan Line*, 441 U.S. at 437, 451. In this regard, it is important to note that the

tests are not mutually exclusive; they overlap to a greater or lesser extent, depending on the facts and circumstances of the particular case. To withstand constitutional scrutiny under these tests, a state tax must not "create[] a substantial risk of international multiple taxation" or "prevent[] the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'" *Ibid.* (citation omitted). In addition, it must be fairly related to the services provided by the State and applied to an activity that has a substantial nexus with the taxing State. *Complete Auto*, 430 U.S. at 279. If a state law violates any of these precepts, it is unconstitutional under the Commerce Clause.

In light of the unique nature of containers as instrumentalities of international traffic, Tennessee's attempt to apply its sales tax to the gross proceeds of container leases directly contravenes the principles articulated in *Complete Auto* and *Japan Line*.[8]

A. Tennessee's Tax Creates A Substantial Risk Of International Multiple Taxation

First and foremost, the application of Tennessee's sales tax to the gross proceeds of container leases violates the Commerce Clause by "creat[ing] a substantial risk of international multiple taxation." *Japan Line*, 441 U.S. at 451. This risk stems from the fact that containers are instrumentalities of foreign commerce that spend the majority of their rental periods overseas, travelling

[8] Although petitioner has not focused on the specific prongs of the *Complete Auto* test, those prongs are clearly encompassed in the question presented in this case, namely, whether the application of Tennessee's sales tax to container leases violates the Foreign Commerce Clause. As this Court held in *Japan Line*, to survive scrutiny under the Foreign Commerce Clause, a state tax must pass the tests set forth in *both Japan Line* and *Complete Auto*. See 441 U.S. at 451. This holding makes perfect sense, given the substantial overlap of the principles animating both tests.

through dozens of foreign countries. These foreign jurisdictions have an equal right to tax the rental proceeds of containers flowing through, and stopping briefly within, their borders. For example, if Japan and France were to impose a use tax on the rent paid for containers used in their territory, the rent paid for a container delivered in Tennessee, but travelling solely between Yokahoma, Le Havre and Sacramento during its lease, would be subject to duplicative taxation by Tennessee, France and Japan (not to mention the potential for additional taxation by California).

The Supreme Court of Tennessee sought to avoid the conclusion that Tennessee's tax creates a risk of multiple taxation by reasoning that "the transfer of possession of cargo containers in Tennessee is a discrete transaction, occurring only within Tennessee." *Itel Containers*, 814 S.W.2d at 36. This reasoning, however, is fatally flawed. Contrary to the Tennessee court's suggestion, Tennessee's tax is not a tax on the delivery or transfer of goods within its borders, but a tax on the proceeds of leases. Indeed, even if it were specifically labeled a tax on delivery or transfer under a lease, it would still be a tax on the gross proceeds of leases because that is the measure of the tax. As this Court recently noted, "[a] tax on sleeping measured by the number of pairs of shoes you have in your closet is a tax on shoes." *Trinova Corp.* v. *Michigan Dept. of Treasury*, 111 S. Ct. 818, 829 (1991) (quotation and citation omitted).

This Court has consistently rejected attempts such as Tennessee's to sustain a tax by characterizing a transaction as occurring only within a single State. In *Central Greyhound Lines, Inc.* v. *Mealy*, 334 U.S. 653 (1948), for example, New York sought to impose a gross receipts tax on interstate motor bus transportation that originated in and terminated in the State. In striking down the tax, the Court properly held that "[t]o say that this commerce is confined to New York is to indulge in pure fiction. To do so, does not eliminate the relation of

[other States] to the transactions nor eliminate the benefits which those * * * States confer upon the portions of the transportation within their borders. Neither their interests nor their responsibilities are evaporated by the verbal device of attributing the entire transportation to New York." *Id.* at 660.

Similarly, in *Michigan-Wisconsin Pipe Line Co.* v. *Calvert*, 347 U.S. 157 (1954), this Court struck down a tax on the delivery within Texas of natural gas to a pipeline, measured by the entire volume of gas to be shipped in interstate commerce, because "[t]his economic process is inherently unsusceptible of division into a distinct local activity capable of forming the basis for the tax here imposed." *Id.* at 167. Likewise, the court's ruling below that the entire lease of a container occurs in Tennessee simply because delivery occurs there is nothing more than pure fiction. By ignoring the relationship that other jurisdictions have to container leases, the court utterly failed to comprehend the real risks of multiple taxation posed by Tennessee's tax.[9]

Specifically, the risk of multiple taxation of container leases is created by the flow of containers through many domestic and foreign taxing jurisdictions that both can and do tax the proceeds of various kinds of leases under theories flatly inconsistent with the fiction that the lease is a "discrete transaction" that "occurs" only in the place of delivery. California, for example, views leases as "continuing purchases" and imposes its use tax upon leased

[9] In finding that Tennessee's tax on container leases falls on a discrete local incident occurring only within Tennessee, the court below relied heavily on *Wardair Canada, Inc.* v. *Florida Dept. of Revenue*, 477 U.S. 1 (1986). In that case the Court held that a sales tax on jet fuel sold to international carriers failed to create a risk of multiple international taxation because the tax was "imposed only upon * * * a discrete transaction which occurs within one national jurisdiction only." *Id.* at 9. But in contrast to a container lease, which occurs in numerous foreign jurisdictions, the sale of aviation fuel is incapable of being taxed by foreign jurisdictions, given that it is typically consumed en route from the United States.

property according to the time spent by the property in the State. Cal. Code Regs. tit. 18, § 1660(b)(2) (1991). Moreover, California does not give a credit for sales or other taxes paid to other States on the same rents subject to its use tax. Cal. Code Regs. tit. 18, § 1660(c)(8) (1991). Thus, if California were to apply its use tax to containers, the same rental payments on containers delivered in Tennessee would be taxed by both California and Tennessee.[10]

Similarly, foreign nations and their various subnational units have the capacity to collect the equivalent of state sales and use taxes upon containers used within their territories. The members of the European Community, for example, impose value added taxes on the rent paid for the use of property within their jurisdiction. See Council Directive 77/388, Arts. 2, 6, & 9, 1977 O.J. (L. 145) 1, 3-5. Similarly, British Columbia generally imposes a use tax on leased property brought into its jurisdiction. See R.S.B.C., c. 388, § 2.1 (1991). The imposition of EC and British Columbia value added and use taxes on container leases would clearly inflict a multiple burden by taxing the same rental payments taxed by Tennessee.

[10] Indeed, most States impose a use tax on rentals of leased property used within their borders. See, *e.g.*, Georgia (Ga. Code Ann. § 48-8-30(3) (Michie 1991)); Illinois (Ill. Rev. Stat. ch. 120, para. 439.2 (1989)); New Jersey (N.J. Stat. Ann. §§ 54:32B-2(e) & (f) and 54:32B-6 (West 1991); N.J. Div. of Tax Notice to Vendors, July 5, 1989, reprinted in, New Jersey Tax Reports, ¶ 400-001 (CCH 1989)); New York (N.Y. Tax Law §§ 1101(b)(4), 1104 (b)(5), 1110 (McKinney 1992)); and Texas (Tex. Admin. Code tit. 34, § 3-294(f)(1) (1992); Comptroller of Public Accountants, Hearing No. 26,852 (June 20, 1991)). Indeed, Tennessee itself imposes a use tax on leased property delivered elsewhere. See Tenn. Code Ann. § 67-6-201, 67-6-102(4)(f) (1989); *Magnavox Consumer Electronics* v. *King*, 707 S.W.2d 504, 505 (Tenn. 1986). Georgia appears to impose a tax on the mere execution of a lease. See 1969 Op. Georgia Atty. Gen., No. 69-146.

Because Tennessee's tax is, like Japan's tax in *Japan Line*, imposed on an unapportioned basis, that is, upon the "full value" of the lease, the imposition of *any* foreign tax on container lease proceeds, even an apportioned one, would "inevitably" result in multiple taxation. *Japan Line*, 441 U.S. at 447. But even if Tennessee were to apportion its tax, container leases would still be subjected to duplicative taxation as soon as any one of dozens of countries through which containers move taxed an unapportioned share of the rental proceeds. "Even a slight overlapping of tax—a problem that might be deemed *de minimus* in a domestic context—assumes importance when sensitive matters of foreign relations and national sovereignty are concerned." *Japan Line*, 441 U.S. at 456. Here, because most foreign countries do not provide for credits for taxes paid to other countries, the risk that Tennessee's tax will result in substantial multiple taxation is extremely high.[11]

The risk that other foreign nations might impose multiple taxation on container leases requires invalidation of Tennessee's attempt to apply its sales tax to such leases. As this Court recognized in *Japan Line*, in the international arena there is no "authoritative tribunal capable of ensuring that the aggregation of taxes is computed on no more than one full value." *Japan Line*, 441 U.S. at 447. Thus, Tennessee cannot be permitted to impose even an apportioned tax on container rentals—much less the unapportioned tax that is at issue in this case. If taxes are

[11] The chaos that would result from upholding Tennessee's tax is aptly illustrated by the following example. If the various foreign nations withdrew their tax exemptions for container leases, the rent paid for a container delivered in Tennessee and used to transport goods from there to Vancouver, British Columbia, and then to Oakland, California, and finally to Paris, France, would be subject to taxation by British Columbia, California and France, as well as by Tennessee. If the Court allows Tennessee to apply its sales tax to container leases, the Court could prevent California from imposing a sales or use tax on the rents taxed by Tennessee but could do nothing to prevent British Columbia or France from taxing them.

to be imposed on container rentals, they must be imposed through the federal government, which, unlike Tennessee, is capable, through the use of the treaty power, of protecting against duplicative taxation of containers.

That no actual multiple international taxation has occurred as of yet is entirely inconsequential. The absence of such taxation is due solely to the common understanding in the international community that containers should be free from sales or similar taxes.[12] Moreover, as this Court has held, the fact "that, for the time being, only one State has taxed is irrelevant to the kind of freedom of trade which the Commerce Clause generated. The immunities implicit in the Commerce Clause and the potential taxing power of a State can hardly be made to depend, in the world of practical affairs, on the shifting incidence of the varying tax laws of the various States at a particular moment." *Freeman* v. *Hewit*, 329 U.S. 249, 256 (1946).[13] This reasoning applies with even

[12] The members of the European Community, for example, have exempted container leases from value added taxation by treating them as within a ruling precluding taxes on the temporary import of goods. See Council Directive 77¶388, Arts. 14(1)(c), 15(1), 1977 O.J. (L. 145) 1. Similarly, the Japan Consumption tax exempts container rents from its scope where the containers are used in international commerce. See Consumption Tax Law, Art. 7(1)(v); Consumption Tax Enforcement Order, Art. 17(2)(ii). British Columbia has informally exempted containers from its use tax on leased property on the basis of an exemption relating to vessels. See R.S.B.C. c. 388 § 4(1)(k) (1991).

[13] See also *Mobil Oil Corp.* v. *Commission of Taxes of Vermont*, 445 U.S. 425, 443 (1980) ("the constitutionality of a [state] tax should not depend on the vagaries of [another State's] tax policy"); *Armco Inc.* v. *Hardesty*, 467 U.S. 638, 644-645 (1986) (the constitutionality of a State's tax laws should not "depend on the shifting complexities of the tax code of 49 other states"); I J. Hellerstein, *State Taxation* ¶ 4.6[1][b], at 119 (1983) (the "actual multiple taxation rule is an unwise and unacceptable method of delineating the State taxing powers under the Commerce Clause" because the constitutionality of a State's statutes ought "not depend upon the present configuration of the statutes of another State") (quoting *General Motors Corp.* v. *Washington*, 377 U.S. 436, 458 (1964)).

greater force in the international sphere. The constitutionality of a state tax should not be made to depend on the present configuration of the various tax codes adopted by the international community of nations.[14]

Thus, because the same rental proceeds from containers subject to tax by Tennessee may be taxed by other foreign countries, Tennessee's tax poses "the risk of a double tax burden * * * which the commerce clause forbids." *J.D. Adams Mfg. Co.* v. *Storen*, 304 U.S. 307, 311 (1938).

B. A State Tax On Container Leases Prevents The Federal Government From Speaking With "One Voice" In The Area Of Foreign Relations

As this Court recognized in *Japan Line*, the Commerce Clause commits to the exclusive authority of the federal government the regulation of those aspects of foreign commerce that by their very nature "necessitate a uniform national rule." 441 U.S. at 449. Pursuant to this rule, a tax will be held invalid if it "prevents the Federal Government from 'speaking with one voice when regulating commercial relations with foreign governments.'" *Id.* at 451. A state tax "will violate the 'one voice' standard if it either implicates foreign policy issues which must be left to the Federal Government or violates a clear federal directive." *Container Corp.* v. *Franchise Tax Board*, 463 U.S. 159, 194 (1983). This latter test is essentially "a species of preemption analysis." *Ibid.* Like the California property tax imposed on containers in *Japan Line*, Tennessee's tax violates both prongs of the "one voice" test.

1. *Tennessee's Tax Violates A Clear Federal Directive*

The plain language of the 1972 Container Convention, as well as the comprehensive network of treaties,

[14] A rule requiring a showing of actual multiple taxation would produce the anomalous result of forcing taxing jurisdictions and taxpayers to go back to court each time a foreign nation passed or repealed a conflicting tax.

statutes, and regulations governing containers, reveal a "clear federal directive" against the application of state sales taxes such as Tennessee's to containers used solely in international commerce. Tennessee's tax specifically contravenes the 1972 Container Convention requirement that signatory nations admit containers "free of import duties and taxes and free of import prohibitions and restrictions." Arts. 1(b), 3, 988 U.N.T.S. 43, 44-45. The term "import duties and taxes" is expansively defined to "mean Customs duties *and all other* duties, *taxes*, fees and other charges which are collected on, or *in connexion with*, the importation of goods." Art. 1(a), 988 U.N.T.S. 44 (emphasis added). Because a tax on the transfer of containers temporarily admitted to the United States as part of a continuous process of importation and exportation is one "in connection with" the import of containers, such a tax directly violates the Convention.[15] This interpretation is strongly supported by the failure of any party to the Convention to impose a sales or similar tax on containers used in international traffic. See *O'Connor* v. *United States*, 479 U.S. 27, 33 (1986); *Trans World Airlines, Inc.* v. *Franklin Mint Corp.*, 466 U.S. 243, 262 (1984).

In addition to contravening the Convention's plain terms, state taxation of container leases conflicts with the express and fundamental purpose of the treaty: "to develop and facilitate international carriage by container." 988 U.N.T.S. 43, 44. Tennessee's tax contravenes this purpose by imposing not only a severe financial burden on container transportation, but a serious administrative burden. If Tennessee's tax is sustained, other States and countries will inevitably respond with taxes of their own on container leases. This multiplicity of tax regimes, each with its own set of detailed regulations, would create

[15] A tax on container leases is also "in connection with" imports insofar as it interferes with the international system of container transportation, thereby impeding the ability of shipping lines to import goods by container.

a bureaucratic nightmare for international container leasing companies and shipping lines in operating their businesses around the world.

Significantly, the blatant inconsistency between state taxation of containers and the goals of the Container Convention was a central aspect of the Court's reasoning in striking down California's property tax on containers in *Japan Line*. In invalidating the tax, the Court explained that "[t]he desirability of uniform treatment of containers used exclusively in foreign commerce is evidenced by the Customs Convention on Containers. * * * The Convention reflects a national policy to remove impediments to the use of containers as 'instruments of international traffic.'" *Japan Line*, 441 U.S. at 452-453 (quoting 19 U.S.C. § 1322(a)). See also *Xerox Corp.* v. *Harris County*, 459 U.S. 145, 151 (1982) (invalidating state taxation of goods stored under bond in Customs bonded warehouses because such taxation conflicted with the policy behind the federal warehouse statutes of "encourag[ing] merchants here and abroad to make use of American ports").

Indeed, the United States itself has recognized the preemptive effect of the Customs Convention on state taxation of containers. What the federal government said with respect to the California tax in its amicus brief in *Japan Line* applies with equal force to the Tennessee tax: it "lessens the effectiveness of the Customs Convention on Containers in aiding foreign commerce and interferes with the comprehensive scheme of federal regulation of instrumentalities of foreign commerce. The state tax thus constitutes an obstacle to the realization of the foreign policy of the United States. It intrudes, as the voice of one of 50 states, into an area where the United States has spoken and should continue to speak with one voice." U.S. Br. as Amicus Curiae, No. 77-1378, at 7-8.

2. *Tennessee's Tax Implicates Foreign Policy Issues That Must Be Left To The Federal Government*

In addition to violating a clear federal directive, state taxation of container leases is invalid because it "implicate[s] foreign policy issues which must be left to the Federal Government." *Container Corp.*, 463 U.S. at 194. To begin with, such taxes would substantially disrupt the ability of the federal government to conduct trade with its foreign trading partners. The federal government's efforts in the international sphere reveal an overarching and coherent policy of reciprocal tax exemptions governing the international container industry. As already indicated, the nation's container relations with foreign governments are implemented through a comprehensive network of treaties and federal statutes and regulations. Pursuant to this network, our trading partners have all refrained from subjecting container leases to sales, use or similar transaction taxes. A decision upholding Tennessee's tax would therefore not only place the federal government in violation of its current treaty obligations, but would substantially diminish its credibility in negotiating future reciprocal agreements with foreign governments.[16]

Perhaps the most dangerous foreign policy implication of Tennessee's tax is the likelihood that it will prompt foreign retaliation against the United States. See *Japan Line*, 441 U.S. at 450. The only reason our foreign trading partners have refrained from imposing sales or similar taxes on containers owned by American companies is the reciprocal international policy of tax exemption. But if the Tennessee tax is upheld, there will exist a

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[16] Moreover, "[i]f other States follow [Tennessee's] example * * * containers will be subject to various degrees of multiple taxation, depending on which American [States] they enter. This result, obviously would make 'speaking with one voice' impossible." *Japan Line*, 441 U.S. at 453.

breach in the international understanding that containers are free from taxation. Because Tennessee may not constitutionally apply its sales tax in a discriminatory manner, that is, to American, but not foreign, leasing companies,[17] there is no question that this breach will spark retaliatory action against the United States by foreign countries whose container leasing companies will be subject to the Tennessee tax. Retaliation may take the form of either general trade sanctions against the United States, or taxes on American container leasing companies whose containers are used in foreign jurisdictions.

Tennessee's tax is also certain to prompt foreign retaliation as a result of its burden on foreign shipping lines, which will be forced to bear an estimated 85 percent of Tennessee's tax. There is no doubt that American leasing companies will follow the mandates of Tennessee law and pass the tax on to their customers—the bulk of which are foreign shipping lines.[18] Thus, even if this Court were to allow Tennessee to apply its tax solely to American leasing companies, foreign retaliation against the United States would still be likely to result from the financial hardship imposed upon foreign shipping lines by Tennessee's tax.

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[17] As Justice Powell concluded, writing for the three members of the *Container Corp.* Court who reached the question, just as a State cannot discriminate against out-of-state residents in favor of its own citizens, it cannot discriminate against a corporation domiciled in another State and "in favor of an overseas corporation" unless it receives "explicit congressional authorization." 463 U.S. at 203 (Powell, J., dissenting).

[18] As noted earlier, while the legal incidence of the Tennessee tax falls on the container lessor, the law provides that it shall be collected from the lessee. Tenn. Code Ann. 67-6-502 (1989). This obligation to collect the tax from the lessee is mandatory. See *Hooten* v. *Carson*, 209 S.W.2d 273, 275 (Tenn. 1948). Indeed, a seller or lessor who fails to collect the tax may subsequently bring an action against the purchaser or lessee for the amount due or paid. See *Sam Carey Lumber Co.* v. *Sixty-One Cabinet Shop, Inc.*, 773 S.W.2d 252, 254-55 (Tenn. App. 1989).

Just as in *Japan Line*, the risk of foreign retaliation is "acute" in this case. 441 U.S. at 453. Eleven countries—the United Kingdom, Germany, France, Italy, Denmark, Finland, Japan, the Netherlands, Norway, Spain, and Sweden—have already lodged a formal complaint regarding Tennessee's tax with the U.S. Department of State. See Diplomatic Note (filed April 28, 1992). These countries charge that a tax on container leases such as Tennessee's is in "direct contravention" of the Customs Convention and "pose[s] an unjustified and unacceptable burden on international shipping companies and their customers." *Ibid.* Given their view of the tax as "unjustified and unacceptable," there can be no doubt that if the Tennessee tax is allowed to stand, these foreign nations will take retaliatory measures that will be felt not only by Tennessee, but "by the Nation as a whole." 441 U.S. at 453.

In addition to the significant threat of foreign retaliation, state taxes on container leases have a number of other foreign commerce implications that demonstrate the need for uniform federal treatment in this area. Specifically, by increasing the cost of the international transport of goods by container, such taxes would raise the trading barriers between America and its foreign trading partners and increase the cost of U.S. exports, thereby discouraging the consumption of American goods overseas.

Furthermore, such taxes would have the perverse effect of inducing international shipping lines—which are not generally subject to sales or similar transaction taxes on containers bought abroad—to buy, rather than lease, containers. This would not only financially devastate the international container leasing industry, but would thwart its salutary function of providing a pooling system that effectively responds to the shifting imbalances in container demand. As a result, the efficient international shipment of goods would be substantially impaired.[19]

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[19] Moreover, if this Court were to allow (or require) States to apply their taxes only to American-owned containers, U.S. con-

While such undesirable effects do not in and of themselves condemn a tax under the Commerce Clause, they demonstrate the serious foreign commerce ramifications of upholding the decision below. They are also wholly at odds with the federal policy, as expressed in the Container Convention and its implementing regulations, of facilitating the international transport of goods by container. Neither Tennessee—nor any other State—can, "by its unilateral act, * * * be permitted to place these impediments before this Nation's conduct of its foreign relations and its foreign trade." *Japan Line*, 441 U.S. at 453.

C. Application Of Tennessee's Sales Tax To The Entire Proceeds Of A Container Lease Is Neither Fairly Related To The Services Provided By The State Nor Supported By A Sufficient Nexus

Tennessee's tax also infringes the Commerce Clause because it is not fairly related to the services provided by Tennessee and because Tennessee lacks a sufficient nexus to tax container leases. See *Complete Auto*, 430 U.S. at 279. Both of these conclusions ineluctably follow from the special characteristics of containers as instrumentalities used exclusively in foreign commerce.

Under the test enunciated by this Court in *Complete Auto*, a tax must be "fairly related to the services provided by the state" in order to pass muster under the Commerce Clause. *Ibid.* A State may exert its taxing power only "in relation to opportunities which it has given, to protection which it has afforded, [and] to benefits which it has conferred by the fact of being an orderly civilized society." *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 625 (1981) (citation omitted).

tainer leasing companies would be at a significant competitive disadvantage versus foreign container leasing companies. Instead of leasing containers from American companies subject to such taxes, international shipping lines would simply lease them from foreign leasing companies. This would deal a severe—if not fatal—blow to the U.S. container leasing industry.

"[W]hen the measure of a tax bears no relationship to the taxpayers' presence or activities in a State, a court may properly conclude under the fourth prong of the *Complete Auto Transit* test that the State is imposing an undue burden on interstate commerce." *American Trucking Ass'ns, Inc.* v. *Scheiner*, 483 U.S. 266, 291 (1987) (quotation omitted).

Tennessee's effort to apply its sales tax to the gross rental proceeds of containers delivered in its borders directly conflicts with these principles. Indeed, Tennessee's tax is more than "unfairly related"; it is grossly disproportionate to the benefits provided to container lessors and lessees. Containers delivered in Tennessee are in the State only for a matter of days before continuing on their international journey. This "interruption of movement in Tennessee [i]s not for the purpose of any use of the Containers prior to the continuation of the international movement." Statement of Stipulated Facts ¶ 78. Yet notwithstanding that containers are only in the State for a brief "interruption," Tennessee still requires lessors to collect, and submit to the State, a tax on each future payment billed under the lease—an obligation that could last for many years. Indeed, because many lease terms are open-ended, lessors could be required to pay a tax to Tennessee indefinitely even though their containers never enter the State again. This gross lack of proportionality between the asserted reach of Tennessee's tax and the benefits provided by the State cannot withstand Commerce Clause scrutiny.[20]

This conclusion is strongly supported by this Court's decisions in *Central Greyhound Lines, Inc.* v. *Mealy*, 334

[20] The total lack of relationship between a tax on the entire proceeds of a container lease and the services provided by Tennessee is clearly illustrated by comparing a container leased for five years with one leased for six months. The former container will be forced to bear a tax burden ten times greater than the latter container bears despite the absence of any difference in the amount of activity or presence in Tennessee.

U.S. 653, 663 (1948), where the Court held that a gross receipts tax on interstate motor bus transportation violated the Commerce Clause because it "makes interstate transportation bear more than 'a fair share of the cost of the local government whose protection it enjoys.'" (citation omitted). Similarly, in *Michigan-Wisconsin Pipeline*, 347 U.S. 157, this Court invalidated a Texas tax on the transfer of natural gas within the State, measured by the entire volume of gas to be shipped in interstate commerce, because it "did not relate to the length of the Texas portion of the pipeline or to the percentage of the taxpayer's business taking place in Texas." *Department of Rev.* v. *Association of Washington Stevedoring Cos.*, 435 U.S. 735, 749 n.18 (1978).[21] If the "fair relationship" prong of *Complete Auto* is to mean anything, a State cannot be allowed to tax the gross rental income of instrumentalities of foreign commerce that have no presence in, or relationship to, the State beyond mere delivery in its borders.[22]

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[21] There is a close analogy between the gas flowing through Texas in *Michigan-Wisconsin Pipeline Co.* and the containers flowing through Tennessee in this case. Like the gas moving through Texas, a container merely passes through a State, "mov[ing] continuously to its outside market" and "ending as contemplated from the beginning beyond the state line." *Michigan-Wisconsin Pipeline Co.*, 347 U.S. at 170. Just as the fact that the gas did not flow immediately out of Texas—it was compressed, cooled, scrubbed and dehydrated at a compressor station owned and operated by the taxpayer (*id.* at 163)—did not allow the State to tax the entire volume of gas, the mere fact of delivery does not allow Tennessee to tax the entire rental payments on containers.

[22] The ephemeral nature of container presence in Tennessee sharply distinguishes this case from *Goldberg* v. *Sweet*, in which the Court found that Illinois' tax on interstate telephone calls was "fairly related to the benefits received by Illinois telephone consumers" because such consumers "subscribe to telephone service in Illinois, own or rent telephone equipment at an Illinois service address, and they receive police and fire protection as well as the other general services provided by the State of Illinois." 488 U.S. 252, 267 (1989).

Because containers merely pass through Tennessee in the midst of their international journey, and are unlikely to enter the State again for the remainder of their lease term, Tennessee also lacks the nexus required to satisfy the Commerce Clause. Neither the lessors nor the lessees of containers typically reside in Tennessee; nor are container leases typically solicited, negotiated, or executed in the State. Indeed, since containers are delivered and picked up by truckers, neither the lessor nor the lessee may ever set foot in Tennessee. In addition, while petitioner happened to own and operate one of the depots to which its containers were delivered in Tennessee for a portion of the lease period, that is atypical. Most depots are owned and operated not by container lessors, but by independent enterprises that pay their own property, income and other applicable taxes to the State.[23]

Moreover, as an analytical matter, containers never even enter Tennessee at all. Containers are admitted in the United States under bond, and subject to reexportation, as "instruments of international traffic." 19 C.F.R. § 10.41a(a)(1) (1991). As such, they are legally treated as never having entered the United States. *Ibid.*[24] It is difficult to see how a container can have *any* nexus with a State—much less one sufficient to support taxation—if it does not even have a legal presence in any of them. See U.S. Br. as Amicus Curiae in *Japan Line*, *supra*, at 30 n.23 (objecting to California's property tax because it was "levied on containers that are still part of foreign commerce and have never been formally entered into United States commerce").

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[23] Thus, if this Court upholds Tennessee's application of its tax in this case, it should at least limit its decision to those taxpayers who own and operate a depot in the taxing State.

[24] Because they do not even enter the commerce of the United States, bonded containers are not properly regarded as "part of the common mass of taxable property within the state." *McGoldrick* v. *Gulf Oil Corp.*, 309 U.S. 414, 429 (1940).

This Court has already indicated that neither the termination of a telephone call nor the delivery of goods by mail or common carrier provides a sufficient nexus for state taxation. See *Goldberg* v. *Sweet*, 488 U.S. 252, 263 (1989); *National Bellas Hess, Inc.* v. *Department of Revenue of Illinois*, 386 U.S. 753, 758 (1967). This conclusion applies with even more force to the mere delivery of containers within a State in light of the "evidence that the Founders intended the scope of the foreign commerce power to be * * * greater" than the interstate commerce power. *Japan Line*, 441 U.S. at 448 (citing historical references).[25] It follows from Congress' greater power over foreign commerce that States require a correspondingly greater nexus to tax such commerce—a nexus that is plainly absent in this case.[26]

* * * *

As Justice Frankfurter has explained, "[t]he task of scrutinizing is a task of drawing lines. This is the historic duty of the Court so long as Congress does not undertake to make specific arrangements between the national government and the States in regard to revenues from interstate [and foreign] commerce. * * * Considerations of proximity and degree are here, as so often in the law, decisive." *Freeman* v. *Hewit*, 329 U.S. 249, 253-254 (1946). The nation's interest in the conduct of its foreign relations and trade outweighs the interest of a State in taxing the entire lease proceeds of an instrumentality of foreign commerce that is subject to a network of U.S. treaties and regulations and that is only temporarily present in the State's borders during the course of international transit. Thus, when the lines are properly drawn in this case, Tennessee's tax must fall.

[25] This Court's cases have "echo[ed] this distinction." *Japan Line*, 441 U.S. at 448 (citing, *inter alia*, *Buttfield* v. *Stranahan*, 192 U.S. 470, 492-493 (1904) (Congress' power over foreign commerce is "exclusive and absolute") and *Bowman* v. *Chicago & N.R. Co.*, 125 U.S. 465, 482 (1888) (laws affecting commerce with foreign nations "are general in their nature, and should proceed exclusively from the legislative authority of the nation")). See also *Wardair Canada, Inc.* v. *Florida Dept. of Revenue*, 477 U.S. 1, 8 (1986) ("allud[ing] to the special need for federal uniformity" in "the unique context of foreign commerce"); *Japan Line*, 441 U.S. at 448 n.13 (while "Congress' power to regulate interstate commerce may be restricted by considerations of federalism and State sovereignty * * *, it has never been suggested that Congress' power to regulate foreign commerce could be so limited").

[26] That containers make their way into the various States does not negate in any way the conclusion that Tennessee's tax is a tax on foreign commerce. As this Court recognized as early as 1824 in the seminal opinion of Chief Justice Marshall in *Gibbons* v. *Ogden*, 22 U.S. (9 Wheat.) 1, 195, foreign commerce "does not stop at the jurisdictional lines of the several States" but proceeds within the states until the movement in commerce is completed." Cf. *Illinois Gas Co.* v. *Public Service Gas*, 314 U.S. 498, 503 504 (1942).

CONCLUSION

The judgment of the Supreme Court of Tennessee should be reversed.

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